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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2002.

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 0-21184

**MICROCHIP TECHNOLOGY INCORPORATED**  
(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**86-0629024**  
(IRS Employer  
Identification No.)

**2355 W. Chandler Blvd., Chandler, AZ 85224-6199**  
**(480) 792-7200**

(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's  
Principal Executive Offices)

The registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days.

Yes ☒ No ☐

The registrant is an accelerated filer (as defined by Rule 12b-2 of the Securities Exchange Act of 1934).

Yes ☒ No ☐

Number of shares of common stock, \$.001 par value, outstanding as of January 31, 2003: **203,448,669 shares.**

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# MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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### **EXHIBITS**

**MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands except share amounts)

**ASSETS**

	December 31, 2002 (Unaudited)	March 31, 2002 (Note 1)
Cash and cash equivalents	\$ 198,231	\$ 280,647
Accounts receivable, net	93,375	80,747
Inventories	93,961	88,615
Prepaid expenses	7,736	6,154
Deferred tax assets	120,731	83,980
Other current assets	72,842	9,033
Total current assets	<u>586,876</u>	<u>549,176</u>
Property, plant and equipment, net	777,753	715,960
Goodwill	30,746	---
Intangible assets, net	5,133	---
Other assets	<u>9,945</u>	<u>10,464</u>
Total assets	<u>\$ 1,410,453</u>	<u>\$ 1,275,600</u>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Accounts payable	\$ 36,621	\$ 38,292
Accrued liabilities	114,669	88,506
Deferred income on shipments to distributors	46,240	40,800
Total current liabilities	<u>197,530</u>	<u>167,598</u>
Pension accrual	1,059	1,091
Deferred tax liability	36,616	31,132
Stockholders' equity:		
Preferred stock, \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding.	---	---
Common stock, \$.001 par value; authorized 450,000,000 shares; issued and outstanding 203,469,181 shares at December 31, 2002; issued 200,802,633 and outstanding 200,629,908 shares at March 31, 2002.	203	201
Additional paid-in capital	490,826	459,303
Retained earnings	684,219	619,254
Less shares of common stock held in treasury at cost; 172,725 shares at March 31, 2002.	---	(2,979)
Net stockholders' equity	<u>1,175,248</u>	<u>1,075,779</u>
Total liabilities and stockholders' equity	<u>\$ 1,410,453</u>	<u>\$ 1,275,600</u>

See accompanying notes to condensed consolidated financial statements

**MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands except per share amounts)  
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2002	2001	2002	2001
Net sales	\$ 170,998	\$ 141,857	\$ 500,491	\$ 422,413
Cost of sales	<u>77,071</u>	<u>70,718</u>	<u>231,158</u>	<u>210,999</u>
Gross profit	<u>93,927</u>	<u>71,139</u>	<u>269,333</u>	<u>211,414</u>
Operating expenses:				
Research and development	22,323	21,409	66,220	61,111
Selling, general and administrative	22,430	19,869	67,498	61,477
Special charges	<u>---</u>	<u>---</u>	<u>50,800</u>	<u>---</u>
	<u>44,753</u>	<u>41,278</u>	<u>184,518</u>	<u>122,588</u>
Operating income	49,174	29,861	84,815	88,826
Other income (expense):				
Interest income	681	1,187	3,155	3,733
Interest expense	(114)	(111)	(372)	(443)
Other, net	<u>(27)</u>	<u>86</u>	<u>160</u>	<u>449</u>
Income before income taxes	49,714	31,023	87,758	92,565
Income tax provision	<u>12,677</u>	<u>7,446</u>	<u>18,732</u>	<u>24,067</u>
Net income	<u>\$ 37,037</u>	<u>\$ 23,577</u>	<u>\$ 69,026</u>	<u>\$ 68,498</u>
Basic net income per share	<u>\$ 0.18</u>	<u>\$ 0.12</u>	<u>\$ 0.34</u>	<u>\$ 0.34</u>
Diluted net income per share	<u>\$ 0.18</u>	<u>\$ 0.11</u>	<u>\$ 0.33</u>	<u>\$ 0.33</u>
Weighted average common shares outstanding	<u>203,109</u>	<u>200,273</u>	<u>202,152</u>	<u>198,881</u>
Weighted average common and potential common shares outstanding	<u>210,929</u>	<u>209,810</u>	<u>210,484</u>	<u>208,124</u>

See accompanying notes to condensed consolidated financial statements

**MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)  
(Unaudited)

	<u>Nine Months Ended December 31,</u>	
	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income	\$ 69,026	\$ 68,498
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	45	43
Provision for inventory valuation	4,750	4,735
Provision for pension accrual	34	87
Gain on sale of fixed assets	---	(240)
Fab 3 impairment charge	41,500	---
Loss on write-down of fixed assets	2,146	---
In-process research and development charge	9,300	---
Depreciation and amortization	82,895	82,588
Deferred income taxes	(24,178)	17,103
Tax benefit from exercise of stock options	17,417	15,488
(Increase) decrease in accounts receivable	(11,553)	12,000
Increase in inventories	(9,597)	(1,292)
Increase (decrease) in accounts payable and accrued liabilities	21,820	(47,655)
Change in other assets and liabilities	(106)	(39,830)
Net cash provided by operating activities	<u>203,499</u>	<u>111,525</u>
Cash flows from investing activities:		
PowerSmart acquisition, net of cash acquired	(50,674)	---
Proceeds from sale of assets	---	1,029
Purchase of Fab 4	(184,717)	---
Capital expenditures	(62,918)	(36,257)
Net cash used in investing activities	<u>(298,309)</u>	<u>(35,228)</u>
Cash flows from financing activities:		
Proceeds from lines of credit	---	2,138
Payment of cash dividend	(4,061)	---
Purchase of treasury stock	(7,473)	---
Proceeds from sale of stock	23,928	37,051
Net cash provided by financing activities	<u>12,394</u>	<u>39,189</u>
Net (decrease) increase in cash and cash equivalents	(82,416)	115,486
Cash and cash equivalents at beginning of period	<u>280,647</u>	<u>129,909</u>
Cash and cash equivalents at end of period	<u>\$ 198,231</u>	<u>\$ 245,395</u>

See accompanying notes to condensed consolidated financial statements

**MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2002**  
**(Unaudited)**

**(1) Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Microchip Technology Incorporated and its wholly owned subsidiaries (the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). In the opinion of management, all adjustments of a normal recurring nature which are necessary for a fair presentation have been included. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such SEC rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2002. The results of operations for the nine months ended December 31, 2002 are not necessarily indicative of the results that may be expected for the year ending March 31, 2003 or for any other period.

Certain reclassifications have been made to conform the prior year amounts to the current period presentation.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), *Business Combinations*, and No. 142 ("SFAS 142"), *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001. In accordance with SFAS Nos. 141 and 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests. Other intangible assets will continue to be amortized over their useful lives. Goodwill will be subject to impairment tests annually, or earlier if indicators of potential impairment exist, using a fair-value-based approach. The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2003 and such rules were applied to the acquisition of PowerSmart, Inc. The annual impairment tests will be performed in the fourth quarter of each fiscal year. As of December 31, 2002, no impairment of goodwill has been recognized. Future goodwill impairment tests may result in a charge to earnings.

**(2) Acquisition of Gresham, Oregon Wafer Fabrication Facility**

On August 23, 2002, the Company completed its acquisition of a semiconductor manufacturing complex in Gresham, Oregon. The Company acquired the facility for \$183.5 million in cash plus direct acquisition costs of approximately \$1.2 million. The facility is situated on an approximately 140-acre campus east of Portland and comprises approximately 826,500 square feet, including approximately 200,000 square feet of clean room space. The facility came equipped with approximately 350 process tools and 170 support tools. The Company plans to initially produce 8-inch wafers on its 0.5 micron and 0.35 micron process technologies at the Gresham facility. The facility also houses offices, meeting rooms and support functions. The facility is expected to be placed into production in the second quarter of fiscal 2004, at which time depreciation will commence.

### **(3) Special Charges**

#### *Fab 3 Impairment Charge*

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), *Accounting for the Impairment or Disposal of Long-Lived Assets*, which is applicable to financial statements for fiscal years beginning after December 15, 2001. SFAS 144 provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of book value or fair value less cost to sell. SFAS 144 was effective for the Company as of April 1, 2002. In accordance with SFAS 144, the Company recorded a \$41.5 million asset impairment charge during the quarter ended September 30, 2002, as described below.

The Company acquired a semiconductor manufacturing facility in Puyallup, Washington, referred to as Fab 3, in July 2000. The original purchase consisted of semiconductor manufacturing facilities and real property. It was the Company's intention to bring Fab 3 to productive readiness and commence volume production of 8-inch wafers using its 0.7 and 0.5 micron process technologies by August 2001. The Company delayed its intended production start up at Fab 3 due to deteriorating business conditions in the semiconductor industry. Fab 3 has never been brought to productive readiness.

As described above in Note 2, in August 2002 the Company acquired a semiconductor manufacturing facility in Gresham, Oregon, referred to as Fab 4. After the acquisition of Fab 4 was completed, the Company undertook an analysis of the potential production capacity at Fab 4. The results of the analysis led the Company to determine that Fab 3's capacity would not be needed in the foreseeable future and during the second quarter the Company committed to a plan to sell Fab 3. The Company has retained a third party broker to market Fab 3 on its behalf. Accordingly, Fab 3 was classified as an asset held-for-sale as of September 30, 2002 and maintained that classification at December 31, 2002.

The Company retained an independent third party firm, other than its independent auditors, to complete a fair value appraisal of Fab 3. The independent third party used the market approach and considered sales of comparable properties in determining the fair value of Fab 3. The comparable sales included eight properties, including the subject property from the Company's prior purchase in 2000. Based on the results of this appraisal, the Company recorded an asset impairment charge on Fab 3 of \$36.9 million, including estimated costs to sell. The remaining value of \$60.2 million was classified as an asset held-for-sale and is included as a component of other current assets at December 31, 2002.

During the quarter ended September 30, 2002, the Company also recorded an asset impairment charge of \$4.6 million to write-down certain excess manufacturing equipment located at Fab 3 to its net realizable value of \$212,000. This manufacturing equipment became "excess" as a result of duplicate equipment acquired in the purchase of Fab 4. The net realizable value for the excess manufacturing equipment was determined based on management estimates. Substantially all of the other manufacturing equipment located at Fab 3 has been transferred to and will be used in the Company's other wafer fabrication facilities located in Chandler, Arizona (Fab 1), Tempe, Arizona (Fab 2) and Gresham, Oregon (Fab 4).

If actual market conditions are less favorable than those estimated in the appraisal, or if future market conditions deteriorate, the net proceeds from the assets held-for-sale could be less than the amount estimated in the financial statements and additional charges could result prior to or at the time of the sale of Fab 3.

#### *PowerSmart In-Process Research and Development Charge*

On June 5, 2002, the Company completed the acquisition of PowerSmart, Inc. in which Microchip acquired all of PowerSmart's outstanding capital stock and assumed certain stock options for consideration of \$54.0 million in cash. The purchase price was allocated among PowerSmart's tangible and intangible assets,

in-process research and development and goodwill based on an independent valuation analysis performed by a firm other than the Company's independent auditors.

The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141, *Business Combinations*, and accordingly, the results of PowerSmart's operations are included in the Company's consolidated results from the date of the acquisition. The acquisition was not considered significant under the rules and regulations of the SEC (Rule 3-05 of Regulation S-X).

The amount paid in excess of the fair value of the net tangible assets has been allocated to separately identifiable intangible assets based upon an independent valuation analysis. An allocation of \$9.3 million of the purchase price was assigned to in-process research and development and was written off at the date of the acquisition in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2, *Business Combinations Accounted for by the Purchase Method*."

An allocation of approximately \$30.7 million of the purchase price was made to goodwill related to the acquisition in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. Goodwill related to the Powersmart acquisition will not be amortized but will be subject to periodic impairment tests. None of the goodwill is expected to be deductible for tax purposes.

An allocation of \$5.6 million of the purchase price was made to core technology and other identifiable intangible assets and will be amortized over their estimated useful lives of seven years.

**(4) Accounts Receivable**

Accounts receivable consists of the following (amounts in thousands):

	December 31, 2002	March 31, 2002
Trade accounts receivable	\$ 96,183	\$ 84,336
Other	1,112	348
	<u>97,295</u>	<u>84,684</u>
Less allowance for doubtful accounts	<u>3,920</u>	<u>3,937</u>
	<u>\$ 93,375</u>	<u>\$ 80,747</u>

**(5) Inventories**

The components of inventories consist of the following (amounts in thousands):

	December 31, 2002	March 31, 2002
Raw materials	\$ 9,620	\$ 7,187
Work in process	56,507	61,724
Finished goods	<u>27,834</u>	<u>19,704</u>
	<u>\$ 93,961</u>	<u>\$ 88,615</u>

Provisions for inventory valuation charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable.



**(6) Property, Plant and Equipment**

Property, plant and equipment consists of the following (amounts in thousands):

	December 31, 2002	March 31, 2002
Land	\$ 11,538	\$ 23,685
Building and building improvements	190,937	191,186
Machinery and equipment	756,118	722,049
Projects in process	323,193	211,098
	<u>1,281,786</u>	<u>1,148,018</u>
Less accumulated depreciation and amortization	504,033	432,058
	<u>\$ 777,753</u>	<u>\$ 715,960</u>

Depreciation and amortization expense attributed to property and equipment was \$82.9 million and \$82.6 million for the nine months ended December 31, 2002 and December 31, 2001, respectively.

**(7) Lines of Credit**

The Company has an unsecured revolving credit facility with a syndicate of banks totaling \$100,000,000, bearing interest at LIBOR plus 0.625%. The Company can elect to increase the facility to \$150,000,000, subject to certain conditions set forth in the credit agreement. This facility has a termination date of May 31, 2003. The Company had no borrowings against this line of credit as of December 31, 2002. The credit facility requires the Company to achieve certain financial ratios and operating results to maintain the credit facility. The Company's ability to fully utilize this credit facility is dependent on it being in compliance with such covenants and ratios. The Company was in compliance with these covenants as of December 31, 2002.

The Company has an additional unsecured short-term line of credit with various financial institutions in Asia totaling \$20,000,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in U.S. Dollars, bearing interest at the Singapore Interbank Offering Rate (SIBOR) of 1.4525% at December 31, 2002 plus 0.75% (average) and expiring on various dates through November 2003. There were no borrowings against this line of credit as of December 31, 2002, and an allocation of \$855,000 of the available line was made, relating to import guarantees associated with the Company's business in Thailand. There are no covenants related to the foreign line of credit.

**(8) Net Income Per Share**

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2002	2001	2002	2001
Net income	\$ 37,037	\$ 23,577	\$ 69,026	\$ 68,498
Weighted average common shares outstanding	203,109	200,273	202,152	198,881
Dilutive effect of stock options	<u>7,820</u>	<u>9,537</u>	<u>8,332</u>	<u>9,243</u>
Weighted average common and potential common shares outstanding	<u>210,929</u>	<u>209,810</u>	<u>210,484</u>	<u>208,124</u>
Basic net income per share	<u>\$ 0.18</u>	<u>\$ 0.12</u>	<u>\$ 0.34</u>	<u>\$ 0.34</u>
Diluted net income per share	<u>\$ 0.18</u>	<u>\$ 0.11</u>	<u>\$ 0.33</u>	<u>\$ 0.33</u>

**(9) Stock Repurchase**

On August 7, 2002, the Company's Board of Directors authorized the Company to repurchase up to 2,500,000 shares of its common stock in the open market or in privately negotiated transactions. During the nine months ended December 31, 2002, the Company purchased 393,700 shares of its common stock for \$7,473,040. All of the purchased shares were reissued by December 31, 2002 to fund stock option exercises and purchases under the Company's employee stock purchase plan. The timing and amount of any future repurchases will depend upon market conditions and corporate considerations.

**(10) Dividend Payments**

On October 28, 2002, the Company announced that its Board of Directors had approved and instituted a quarterly cash dividend on its common stock. The initial quarterly dividend of \$0.02 per share was paid on December 6, 2003 in the amount of \$4,060,766. A second quarterly dividend payment was declared on January 21, 2003 in the amount of \$0.02 per share and will be paid on February 28, 2003 to shareholders of record as of February 7, 2003. The Company expects its second quarterly dividend payment to be approximately \$4.1 million.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Results of Operations

The following table sets forth certain operational data as a percentage of net sales for the periods indicated:

	Three Months Ended December 31, (Unaudited)		Nine Months Ended December 31, (Unaudited)	
	2002	2001	2002	2001
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	<u>45.1%</u>	<u>49.9%</u>	<u>46.2%</u>	<u>50.0%</u>
Gross profit	54.9%	50.1%	53.8%	50.0%
Research and development	13.0%	15.1%	13.2%	14.5%
Selling, general and administrative	13.1%	14.0%	13.5%	14.5%
Special charges	<u>0.0%</u>	<u>0.0%</u>	<u>10.2%</u>	<u>0.0%</u>
Operating income	<u>28.8%</u>	<u>21.0%</u>	<u>16.9%</u>	<u>21.0%</u>

#### *Net Sales*

We operate in one industry segment and engage primarily in the design, development, manufacture and marketing of semiconductor products. We sell our products to distributors and original equipment manufacturers, referred to as OEMs, in a broad range of market segments, perform on-going credit evaluations of our customers and generally require no collateral.

Our net sales for the quarter ended December 31, 2002 were \$171.0 million, an increase of 0.7% from the previous quarter's sales of \$169.7 million, and an increase of 20.5% from net sales of \$141.9 million in the quarter ended December 31, 2001.

Our net sales for the nine months ended December 31, 2002 were \$500.5 million, an increase of 18.5% from net sales of \$422.4 million for the nine months ended December 31, 2001.

The increases in net sales for the three and nine-month periods ended December 31, 2002, compared to the three and nine-month periods ended December 31, 2001, were primarily due to increased demand, predominantly for our proprietary microcontroller and analog and interface products. Key factors in our success in achieving these increases in net sales during the three and nine-month periods ended December 31, 2002 include:

- continued market share gains
- increasing semiconductor content in our customers' products
- our new product offerings that have increased our served available market, and
- increasing demand for our programmable products.

Sales by product line for the three and nine-month periods ended December 31, 2002 and December 31, 2001 were as follows (in thousands):

	Three Months Ended December 31, (Unaudited)				Nine Months Ended December 31, (Unaudited)			
	2002	%	2001	%	2002	%	2001	%
Microcontrollers	\$ 137,227	80.3%	\$ 110,384	77.8%	\$ 393,678	78.7%	\$ 326,439	77.3%
Memory products	20,755	12.1%	21,725	15.3%	68,750	13.7%	64,167	15.2%
Analog and interface products	<u>13,016</u>	<u>7.6%</u>	<u>9,748</u>	<u>6.9%</u>	<u>38,063</u>	<u>7.6%</u>	<u>31,807</u>	<u>7.5%</u>
Total sales	<u>\$ 170,998</u>	<u>100.0%</u>	<u>\$ 141,857</u>	<u>100.0%</u>	<u>\$ 500,491</u>	<u>100.0%</u>	<u>\$ 422,413</u>	<u>100.0%</u>

Certain reclassifications have been made to conform the prior period amounts to the current period presentation.

#### Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 80% of our total net sales for the three-month period ended December 31, 2002, and approximately 79% of our total net sales for the nine-month period ended December 31, 2002.

Microcontrollers and associated applicable development systems accounted for approximately 78% of our total net sales for the three-month period ended December 31, 2001, and approximately 77% of our total net sales for the nine-month period ended December 31, 2001.

Net sales of our microcontroller products increased approximately 24% in the three-month period ended December 31, 2002, and 21% in the nine-month period ended December 31, 2002, compared to the three and nine-month periods ended December 31, 2001. These sales increases were primarily due to increased demand for our microcontroller products in end markets, driven principally by market share gains and those factors described above at page 11. The end markets that we serve include the automotive, communications, computing, consumer and industrial control markets.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller products have remained relatively constant over time due to the proprietary nature of these products. We have experienced, and expect to continue to experience, moderate pricing pressure in certain microcontroller product lines, primarily due to competitive conditions. We have been able to in the past, and expect to be able to in the future, moderate average selling price declines in our microcontroller product lines by introducing new products with more features and higher prices. We may be unable to maintain average selling prices for our microcontroller products as a result of increased pricing pressure in the future, which would adversely affect our operating results.

#### Memory Products

Sales of our memory products accounted for approximately 12% of our total net sales for the three-month period ended December 31, 2002, and approximately 14% of our total net sales for the nine-month period ended December 31, 2002.

Sales of our memory products accounted for approximately 15% of our total net sales in each of the three and nine-month periods ended December 31, 2001.

Net sales of our memory products decreased approximately 5% in the three-month period ended December 31, 2002, and increased approximately 7% in the nine-month period ended December 31, 2002, compared to the three and nine-month periods ended December 31, 2001. These sales fluctuations were driven primarily by customer demand conditions within the Serial EEPROM market, which products comprise substantially all of our memory product net sales.

Serial EEPROM product pricing has historically been cyclical in nature, with steep price declines followed by periods of relative price stability, driven by changes in industry capacity at different stages of the business cycle. During the periods covered by this report, we have experienced several Serial EEPROM product pricing trends due to market conditions. We experienced significant competitive downward pricing pressures in our Serial EEPROM product lines during the first half of fiscal 2002, returning to modest pricing declines in the second half of fiscal 2002. Serial EEPROM pricing was essentially flat during first half of fiscal 2003, and down approximately 9% in the quarter ended December 31, 2002. We have experienced, and expect to continue to experience, varying degrees of competitive pricing pressures in our Serial EEPROM products. We may be unable to maintain the average selling prices of our Serial EEPROM products as a result of increased pricing pressure in the future, which would adversely affect our operating results.

#### Analog and Interface Products

Sales of our analog and interface products accounted for approximately 8% of our total net sales in each of the three and nine-month periods ended December 31, 2002 and December 31, 2001.

Net sales of our analog and interface products increased approximately 34% in the three-month period ended December 31, 2002, and 20% in the nine-month period ended December 31, 2002, compared to the three and nine-month periods ended December 31, 2001. These sales increases were driven primarily by new proprietary design wins, supply and demand conditions within the market and our ability to gain market share.

Analog and interface products can be proprietary or non-proprietary in nature. Currently, we consider approximately 45% of our analog and interface product mix to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog and interface business will experience price fluctuations, driven primarily by the current supply and demand for those products. During the three-month period ended December 31, 2002, pricing of our non-proprietary analog and interface products was approximately flat compared to the three-month period ended September 30, 2002. During the nine-month period ended December 31, 2002, pricing of our non-proprietary analog and interface products was approximately flat compared to the three-month period ended March 31, 2002. We have experienced, and expect to continue to experience, moderate pricing pressure in certain analog and interface product lines, primarily due to competitive conditions. We may be unable to maintain the average selling prices of our analog and interface products as a result of increased pricing pressure in the future, which would adversely affect our operating results. We anticipate the proprietary portion of our analog and interface products to increase over time.

#### Turns Orders

Our net sales in any given quarter depend upon a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. We measure turns orders at the beginning of a quarter based on the orders needed to meet the revenue target that we set entering the quarter. We emphasize our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with short delivery schedules. Turns orders directly correlate to product lead times, which are generally three weeks or less for the majority of our products, essentially unchanged from lead times a year ago. Shorter lead times generally mean that turns orders as a percentage of our business are relatively high in

any particular quarter and reduces our visibility on future product shipments. With current lead times for the majority of our products being three weeks or less, generally, customers do not place orders beyond their immediate requirements.

The percentage of turns orders in any given quarter is dependent on overall semiconductor industry conditions and product lead times. As such, our percentage of turns orders has fluctuated over the last three fiscal years between 20% and 63%. At October 1, 2002, we required turns orders of approximately 60% in order to achieve our revenue for the third quarter of fiscal 2003.

Turns orders are difficult to predict, and we may not experience the combination of turns orders and shipments from backlog in a quarter that would be sufficient to achieve anticipated net sales. If we do not achieve a sufficient level of turns orders in a particular quarter, our net sales and operating results will suffer.

*The foregoing statements regarding competitive pricing pressure in our microcontroller, Serial EEPROM and analog and interface product lines, our ability to moderate future average selling price declines in our microcontroller product lines and the proprietary portion of our analog and interface product lines increasing over time are forward-looking statements. Actual results could differ materially because of the following factors, among others: the level of orders that are received and can be shipped in a quarter; changes in demand for our products and the products of our customers; the level at which previous design wins become actual orders and sales; inventory mix and timing of customer orders; customers' inventory levels, order patterns and seasonality; level of sell-through of our products through distribution in any particular fiscal period; possible disruptions to our customers' operations occasioned by any slow down or cessation in international transport or delivery caused by labor strikes or work stoppages at international ports of delivery in the United States or elsewhere which could result in reduced customer purchases relative to our expectations; our ability to ramp products into volume production; competition and competitive pressures on pricing and product availability; disruptions in commercial activities, or international transport or delivery occasioned by terrorist activity, armed conflict, war or an unexpected increase in the price of, or decrease in the supply of, oil resulting in reduced end-user purchases relative to expectations; impact of events outside the United States, such as the business impact of fluctuating currency rates or unrest or political instability; the cyclical nature of both the semiconductor industry and the markets addressed by our products; market acceptance of our new products and those of our customers; the financial condition of our customers; fluctuations in production yields, production efficiencies and overall capacity utilization; changes in product mix; absorption of fixed costs, labor and other fixed manufacturing costs; and general industry, economic and political conditions.*

### Distribution

Distributors accounted for approximately 57% of our net sales in the three-month period ended December 31, 2002, and 60% of our net sales in the three-month period ended December 31, 2001. Distributors accounted for approximately 59% of our net sales in the nine-month period ended December 31, 2002, and 61% of our net sales in the nine-month period ended December 31, 2001.

Our largest distributor accounted for approximately 11% of our net sales in the three-month period ended December 31, 2002, and 12% of our total net sales in the three-month period ended December 31, 2001. Our largest distributor accounted for approximately 11% of our total net sales in the nine-month period ended December 31, 2002, and 12% of our total net sales in the nine-month period ended December 31, 2001.

Generally, we do not have long-term agreements with our distributors, and we or our distributors may terminate their relationships with us with little or no advanced notice. The loss of, or the disruption in the operations of, one or more of our distributors could reduce our future net sales in a given quarter and could result in an increase in inventory returns.

## Sales By Geography

Sales by geography for the three and nine-month periods ended December 31, 2002 and 2001 were as follows (in thousands):

	Three Months Ended December 31, (Unaudited)				Nine Months Ended December 31, (Unaudited)			
	2002	%	2001	%	2002	%	2001	%
Americas	\$ 57,321	33.5%	\$ 47,467	33.5%	\$ 169,038	33.8%	\$ 143,937	34.1%
Europe	42,217	24.7%	43,188	30.4%	129,827	25.9%	132,799	31.4%
Asia	<u>71,460</u>	<u>41.8%</u>	<u>51,202</u>	<u>36.1%</u>	<u>201,626</u>	<u>40.3%</u>	<u>145,677</u>	<u>34.5%</u>
Total Sales	<u>\$ 170,998</u>	<u>100.0%</u>	<u>\$ 141,857</u>	<u>100.0%</u>	<u>\$ 500,491</u>	<u>100.0%</u>	<u>\$ 422,413</u>	<u>100.0%</u>

Our sales to foreign customers have been predominately in Asia and Europe, which we attribute to the manufacturing strength in those areas for automotive, communications, computing, consumer and industrial control products. Americas sales include sales to customers in the United States, Canada, Central America and South America.

Sales to foreign customers accounted for approximately 71% of our net sales in the three and nine months ended December 31, 2002 and approximately 69% of our net sales in the three and nine months ended December 31, 2001. The majority of our foreign sales are U.S. Dollar denominated.

## *Gross Profit*

Our gross profit was \$93.9 million in the three months ended December 31, 2002, and \$71.1 million in the three months ended December 31, 2001. Our gross profit was \$269.3 million in the nine months ended December 31, 2002, and \$211.4 million in the nine months ended December 31, 2001.

Gross profit as a percent of sales was 54.9% in the three months ended December 31, 2002, and 50.1% in the three months ended December 31, 2001. Gross profit as a percent of sales was 53.8% in the nine months ended December 31, 2002, and 50.0% in the nine months ended December 31, 2001.

The most significant factors affecting gross profit percentage in the periods covered by this report were:

- higher levels of manufacturing capacity utilization in fiscal 2003, compared to fiscal 2002
- continued cost reductions in wafer fabrication and assembly and test manufacturing
- our ability to maintain average selling prices for our microcontroller products where moderate downward pricing pressures have been offset by introduction of new products with more features and higher selling prices
- varying factors impacting the average selling prices of our Serial EEPROM products
- fluctuations in the product mix of proprietary microcontroller and analog products and related Serial EEPROM products
- the sale of inventory that was previously reserved for, and
- one-week plant shutdowns in each quarter of fiscal 2002.

During fiscal 2002, we operated at approximately 70% of our cumulative total Fab 1 (Chandler, Arizona) and Fab 2 (Tempe, Arizona) capacity due to the capacity reductions implemented in the March 2001 quarter and one-week plant shutdowns in each quarter of fiscal 2002. Our overall gross margins in fiscal 2002 were

negatively impacted by these actions due to the relatively high fixed costs inherent in our wafer fabrication manufacturing. Capacity utilization increased to approximately 83% in the first quarter of fiscal 2003, 84% in the second quarter of fiscal 2003, and 86% in the third quarter of fiscal 2003, which favorably impacted gross margins, compared to the gross margins attained in fiscal 2002.

Our overall inventory levels were \$93.9 million as of December 31, 2002, compared to \$88.6 million at March 31, 2002. We maintained 111 days of inventory on our balance sheet as of December 31, 2002, compared to 110 days as of March 31, 2002. The highest number of days of inventory that we experienced in either fiscal 2002 or fiscal 2003 was 127 days as of September 30, 2001.

As of December 31, 2002, Fab 3 (Puyallup, Washington) was not an active operating asset. We are currently holding Fab 3 as an asset held-for-sale and are maintaining it at minimal operating cost. See "Special Charges – Fab 3 Impairment Charge," below at page 18, for a discussion of the status of Fab 3.

Fabs 1 and 2 currently utilize various manufacturing process technologies, but predominantly utilize our 1.0 to 0.5-micron processes. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. In fiscal 2002 and the first three-quarters of fiscal 2003, approximately 80% of our production was on 8-inch wafers.

We anticipate that gross margins will fluctuate over time, driven primarily by the overall product mix of microcontroller, analog and interface and memory products and the percentage of net sales of each of these products in a particular quarter, as well as manufacturing yields, fixed cost absorption, wafer fab loading levels and competitive and economic conditions.

*The foregoing statements relating to our transition to advanced process technologies to reduce future manufacturing costs and the fluctuation of gross margins over time are forward-looking statements. Actual results could differ materially because of the following factors, among others: changes in demand for our products and the products of our customers; fluctuations in production yields, production efficiencies and overall capacity utilization; changes in capacity utilization; absorption of fixed costs, labor and other direct manufacturing costs; competition and competitive pressure on pricing; possible disruptions to our customers' operations occasioned by any slow down or cessation in international transport or delivery caused by labor strikes or work stoppages at international ports of delivery in the United States or elsewhere which could result in reduced customer purchases relative to our expectations; disruptions in commercial activities, or international transport or delivery occasioned by terrorist activity, armed conflict, war or an unexpected increase in the price of, or decrease in the supply of, oil resulting in reduced end-user purchases relative to expectations; impact of events outside the United States, such as the business impact of fluctuating currency rates or unrest or political instability; our ability to increase manufacturing capacity as needed; cost and availability of raw materials; changes in product mix; and other general industry, economic and political conditions.*

At December 31, 2002, approximately 76% of our assembly requirements were being performed in our Thailand facility, compared to approximately 50% as of December 31, 2001. Third-party contractors located throughout Asia perform the balance of our assembly operations. Substantially all of our test requirements were being performed in our Thailand facility as of December 31, 2002 and December 31, 2001. We believe that the assembly and test operations performed at our Thailand facility provide us with significant cost savings when compared to third-party contractor assembly and test costs, as well as increased control over these portions of the manufacturing process.

Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. While we review the quality, delivery and cost performance of our third-party contractors, our future operating results could suffer if any third-party contractor is unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.



Our reliance on foreign operations, maintenance of substantially all of our finished goods in inventory at foreign locations, and significant foreign sales exposes us to foreign political and economic risks, including:

- political, social and economic instability
  - trade restrictions and changes in tariffs
  - import and export license requirements and restrictions
  - difficulties in staffing and managing international operations
  - employment regulations
  - disruptions in international transport or delivery
  - fluctuations in currency exchange rates
  - difficulties in collecting receivables
- economic slowdown in the worldwide markets served by us, and
- potentially adverse tax consequences.

To date, we have not experienced any significant interruptions in our foreign business operations. If any of these risks materialize, our sales could decrease and our operating results could suffer.

#### *Research and Development*

Research and development (R&D) expenses for the three months ended December 31, 2002 were \$22.3 million, or 13.0% of sales, compared to \$21.4 million, or 15.1% of sales, for the three months ended December 31, 2001. R&D expenses for the nine months ended December 31, 2002 were \$66.2 million, or 13.2% of sales, compared to \$61.1 million, or 14.5% of sales, for the nine months ended December 31, 2001.

We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. We expense all R&D costs as incurred. R&D expenses include expenditures for labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses increased \$0.9 million, or 4.3%, for the three months ended December 31, 2002, compared to the three months ended December 31, 2001. R&D expenses increased \$5.1 million, or 8.4%, for the nine months ended December 31, 2002, compared to the nine months ended December 31, 2001. The primary reasons for the dollar increases in R&D costs in each of these periods was increased labor and professional service costs associated with expanding our technical resources and the ongoing R&D expenses acquired as part of the acquisition of PowerSmart, Inc. described below on page 19. R&D expenses were essentially flat in the three months ended December 31, 2002, compared to the three months ended September 30, 2002.

#### *Selling, General and Administrative*

Selling, general and administrative expenses for the three months ended December 31, 2002 were \$22.4 million, or 13.1% of sales, compared to \$19.9 million, or 14.0% of sales, for the three months ended December 31, 2001. Selling, general and administrative expenses for the nine months ended December 31, 2002 were \$67.5 million, or 13.5% of sales, compared to \$61.5 million, or 14.6% of sales, for the nine months ended December 31, 2001.

Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force and field applications engineers who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses increased \$2.6 million, or 12.9%, for the three months ended December 31, 2002, compared to the three months ended December 31, 2001. Selling, general and administrative expenses increased \$6.0 million, or 9.8%, for the nine months ended December 31, 2002, compared to the nine months ended December 31, 2001. The primary reason for the dollar increase in selling, general and administrative costs in these periods relate to increased labor costs. Selling, general and administrative expenses decreased \$0.7 million, or 3.0%, for the three months ended December 31, 2002, compared to the three months ended September 30, 2002 as a result of a variety of reductions in administrative costs.

Selling, general and administrative expenses are a component of operating expenses that fluctuate over time, primarily due to revenue and operating expense investment levels.

### *Special Charges*

#### Fab 3 Impairment Charge

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "*Accounting for the Impairment or Disposal of Long-Lived Assets*," which is applicable to financial statements for fiscal years beginning after December 15, 2001. SFAS 144 provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction because assets held-for-sale are not depreciated and are stated at the lower of book value or fair value less cost to sell. SFAS 144 is effective for all of our financial statements issued in fiscal 2003. In accordance with SFAS 144, we recorded a \$41.5 million asset impairment charge during the quarter ended September 30, 2002, as described below.

We acquired Fab 3, a semiconductor manufacturing facility in Puyallup, Washington, in July 2000. The original purchase consisted of semiconductor manufacturing facilities and real property. It was our intention to bring Fab 3 to productive readiness and commence volume production of 8-inch wafers using our 0.7 and 0.5 micron process technologies by August 2001. We delayed our production start up at Fab 3 due to deteriorating business conditions in the semiconductor industry. Fab 3 has never been brought to productive readiness.

On August 23, 2002, we acquired a semiconductor manufacturing facility in Gresham, Oregon, which we refer to as Fab 4. See Note 2 to the Condensed Consolidated Financial Statements on page 6, above. We decided to purchase Fab 4 instead of bringing Fab 3 to productive readiness because, among other things, the cost of the manufacturing equipment needed to ramp production at Fab 3 over the next several years was significantly higher than the total purchase price of Fab 4, and the time to bring Fab 4 to productive readiness was significantly less than the time required to bring Fab 3 to productive readiness.

After the acquisition of Fab 4 was completed, we undertook an analysis of the potential production capacity at Fab 4. The results of the production capacity analysis led us to determine that Fab 3's capacity would not be needed in the foreseeable future and during the second quarter we committed to a plan to sell Fab 3. We have retained a third party broker to market Fab 3 on our behalf. Accordingly, Fab 3 was classified as an asset held-for-sale as of September 30, 2002 and maintained that classification at December 31, 2002.

We retained an independent third party firm, other than our independent auditors, to complete a fair value appraisal of Fab 3. The independent third party used the market approach and considered sales of comparable properties in determining the fair value of Fab 3. The comparable sales included eight properties, including Fab 3 from our purchase in 2000. Based on the results of this appraisal, we recorded an asset impairment charge on Fab 3 of \$36.9 million, including estimated costs to sell. The remaining value of \$60.2 million is classified as an asset held-for-sale and is included as a component of other current assets at December 31, 2002.

During the quarter ended September 30, 2002, we also recorded an asset impairment charge of \$4.6 million to write-down certain excess manufacturing equipment located at Fab 3 to its net realizable value of \$212,000. This manufacturing equipment became "excess" as a result of duplicate equipment acquired in the

purchase of Fab 4. The net realizable value for the excess manufacturing equipment was determined based on management estimates. Substantially all of the other manufacturing equipment located at Fab 3 has been transferred to and will be used in our other wafer fabrication facilities located in Chandler, Arizona (Fab 1), Tempe, Arizona (Fab 2) and Gresham, Oregon (Fab 4).

If actual market conditions are less favorable than those estimated in the appraisal, or if future market conditions deteriorate, the net proceeds from the assets held-for-sale could be less than the amount estimated in the financial statements and additional charges could result prior to or at the time of the sale of the facility.

#### PowerSmart In-Process Research and Development Charge

During the quarter ended June 30, 2002, purchased in-process research and development of \$9.3 million, associated with our acquisition of PowerSmart, Inc. was written off at the date of the acquisition (June 5, 2002) in accordance with FASB Interpretation No. 4, "*Applicability of FASB Statement No. 2 Business Combinations Accounted for by the Purchase Method.*" The value assigned to the in-process research and development was determined by an independent valuation analysis performed by a firm other than our independent auditors. As of the valuation date, there were 15 projects that were considered to be in-process. The values of the projects were determined based on analyses of cash flows to be generated by the products that are expected to result from the in-process projects. These cash flows were estimated by forecasting total revenues expected from these products then deducting appropriate operating expenses, cash flow adjustments and contributory asset returns to establish a forecast of net return on in-process technology. These net returns were substantially reduced to take into account the time value of money and the risks associated with the inherent difficulties and uncertainties in achieving commercial readiness. The above analysis resulted in \$9.3 million of value assigned to acquired in-process research and development, which was expensed on the acquisition date in accordance with FIN 4. We believe the assumptions used in valuing the in-process research and development are reasonable, but are inherently uncertain, and no assurance can be given that the assumptions made will occur. During the nine months ended December 31, 2002, we incurred development costs of approximately \$2.1 million related to the acquired in-process research and development, and should the projects continue to move toward commercialization, we estimate that future expenditures could approximate \$2.9 million over the next few years. None of the in-process research and development projects had been completed as of December 31, 2002.

There were no such special charges incurred during the three and nine-month periods ended December 31, 2001.

*The foregoing statement relating to our estimated future expenditures on the acquired in-process R&D projects is a forward-looking statement. Actual results could differ materially because of the following factors, among others: delays in completion of a particular project; changes in our prioritization of projects; changes in the specifications of a particular project; unforeseen engineering problems; and unanticipated costs.*

#### *Other Income (Expense)*

Interest income decreased in the three and nine-month periods ended December 31, 2002 from the corresponding periods of the previous fiscal year due to lower invested cash balances as a result of our August 23, 2002 acquisition of Fab 4 and our June 5, 2002 acquisition of PowerSmart. Additionally, the interest rates applying to our invested cash balances were lower during the three and nine-month periods ended December 31, 2002, compared to the rates applying during the corresponding periods of the previous fiscal year.

#### *Income Taxes*

Provisions for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings. We had an effective tax rate of 21.3% for the nine months ended December 31, 2002, and 26.0% for the nine months ended December 31, 2001. During the nine months ended December 31, 2002, our effective tax rate was lower than it has been historically due to the special charge incurred during the second quarter of fiscal 2003. Under

Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, we provide for an income tax provision/benefit for special charges in the period in which they occur separately from our calculation of the estimated effective tax rate for the remainder of our operations. Given that the special charge in the second quarter of fiscal 2003 was incurred in the United States, we provided a tax benefit in the September 30, 2002 quarter based on the 40% U.S. tax rate that we expect to apply to the special charges. Excluding special charges, our effective tax rate for the nine months ended December 31, 2002 was 25.5%.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax asset will be recovered from future taxable income within the relevant jurisdiction and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. We have not provided for a valuation allowance because we believe that our deferred tax asset will be recovered from future taxable income. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. At December 31, 2002, our gross deferred tax asset was \$120.7 million. Numerous taxing authorities in the countries in which we do business are increasing their scrutiny of various tax structures employed by businesses. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon audit in the United States and the other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently under audit by the U.S. Internal Revenue Service for our fiscal years ended March 31, 1998, 1999, 2000 and 2001.

*The foregoing statements regarding the recoverability of our deferred tax asset from our future taxable income and the adequacy of our tax reserves to offset any potential tax liabilities that may arise upon audit are forward-looking statements. Actual results could differ materially because of the following factors, among others: current and future tax laws and regulations; taxation rates in geographic regions where we have significant operations; results of any current or future audit conducted by the U.S. Internal Revenue Service or other taxing authorities in the countries in which we do business; and the level of our taxable income and whether our taxable income will be sufficient to utilize our deferred tax asset.*

#### *Euro Conversion Issues*

We operate in the European Market and currently generate approximately 24.7% of our total net sales from customers located in Europe. Our commercial headquarters in Europe are located in the United Kingdom, which is not currently one of the 11 member states of the European Union that has converted to the Euro.

We currently conduct approximately 96.3% of our business in Europe in U.S. Dollars and approximately 0.2% of our business in Europe in Pounds Sterling. The balance of our net sales in Europe is conducted in the Euro. We will monitor the potential commercial impact of conversion of a portion of our current business to the Euro, but we do not currently anticipate any material impact to our business or operations based on this transition.

#### *Liquidity and Capital Resources*

We had \$198.2 million in cash and cash equivalents at December 31, 2002, a decrease of \$82.4 million from the March 31, 2002 balance. The decrease in cash and cash equivalents over this time period is primarily

attributable to the cash used in our June 5, 2002 acquisition of PowerSmart and our August 23, 2002 acquisition of Fab 4, offset by cash generated from operating activities.

We maintain an unsecured revolving credit facility with a syndicate of banks totaling \$100.0 million. We can elect to increase the facility to \$150.0 million, subject to certain conditions set forth in the credit agreement. This facility has a termination date of May 31, 2003. There were no borrowings against this line of credit as of December 31, 2002. We are required to achieve certain financial ratios and operating results to maintain this line of credit and were in compliance with these requirements at December 31, 2002. During the fourth quarter of fiscal 2003 we will begin the process of evaluating a new credit facility to replace the facility that terminates on May 31, 2003.

We also maintain an unsecured short-term line of credit with various financial institutions in Asia totaling \$20.0 million (U.S. Dollar equivalent). There were no borrowings under the foreign line of credit as of December 31, 2002, but an allocation of approximately \$0.9 million of the available line was made, relating to import guarantees associated with our business in Thailand. There are no covenants related to the foreign line of credit.

At December 31, 2002, an aggregate of \$119.1 million of our credit facilities was available, subject to financial covenants and ratios with which we were in compliance. Our ability to fully utilize our credit facilities is dependent on our remaining in compliance with such covenants and ratios.

During the nine months ended December 31, 2002, we generated \$203.5 million of cash from operating activities, an increase of \$92.0 million from the nine months ended December 31, 2001. The increase in cash flow from operations was primarily due to the non-cash impact of the \$41.5 million Fab 3 impairment charge and the \$9.3 million in-process research and development charge, and the impact of changes in accounts payable and accrued liabilities and other assets and liabilities.

During the nine months ended December 31, 2002, net cash used in investing activities increased \$263.1 million, to \$298.3 million, from \$35.2 million for the nine months ended December 31, 2001. The increase was due to our acquisitions of Fab 4 and PowerSmart and increased capital expenditures.

We enter into hedging transactions from time to time in an attempt to minimize our exposure to currency rate fluctuations. Although none of the countries in which we conduct significant foreign operations have had a highly inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future.

On August 7, 2002, our Board of Directors authorized the repurchase up to 2,500,000 shares of our common stock in the open market or in privately negotiated transactions. As of December 31, 2002, we had repurchased 393,700 shares of common stock for \$7,473,040. As of December 31, 2002, all of the purchased shares had been reissued to fund stock option exercises and purchases under our employee stock purchase plan. The timing and amount of any future repurchases will depend upon market conditions and corporate considerations.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the nine months ended December 31, 2002 were \$247.6 million, compared to \$36.3 million for the nine months ended December 31, 2001. The primary reasons for the dollar increase in capital expenditures in the nine-month period ended December 31, 2002 were the purchase of Fab 4, other selective investments to increase our manufacturing capacity in response to market demand and our continued investment in R&D equipment. We currently intend to spend approximately \$70 million during the next 12 months to invest in equipment and facilities to maintain, and selectively increase, capacity to meet our currently anticipated needs.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. The initial quarterly dividend of \$0.02 per share was paid on December 6, 2003 in the amount of \$4,060,766. A second quarterly dividend payment was declared on January 21, 2003 in the amount of \$0.02 per share and will be paid on February 28, 2003 to shareholders of record as of February 7, 2003. We expect our second quarterly dividend payment to be approximately \$4.1 million.

We expect to finance capital expenditures through our existing cash balances, cash flows from operations, available debt arrangements and other sources of financing, including possible issuances of equity and debt securities depending on market conditions. We believe that the capital expenditures anticipated to be incurred over the next 12 months will provide sufficient manufacturing capacity to meet our currently anticipated needs.

*The foregoing statements regarding the anticipated level of capital expenditures over the next 12 months, the nature of such expenditures, the financing and sufficiency of our capital expenditures and the belief that capital expenditures anticipated to be incurred over the next 12 months will provide us sufficient manufacturing capacity to meet our currently anticipated needs are forward-looking statements. Actual results could differ materially because of the following factors, among others: changes in demand for our products and those of our customers; changes in utilization of current manufacturing capacity; unanticipated costs in bringing Fab 4 on-line; market acceptance of our products and of our customers' products; the cyclical nature of the semiconductor industry and the markets addressed by our products; the availability and cost of raw materials, equipment and other supplies; actual levels of capital expenditures; the costs and outcome of any litigation involving intellectual property, customer or other issues; the financial condition of our customers and vendors; uninsured losses; and the economic, political and other conditions in the worldwide markets served by us.*

Net cash provided by financing activities was \$12.4 million for the nine months ended December 31, 2002, compared to \$39.2 million for the nine months ended December 31, 2001. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plan were \$23.9 million in the nine months ended December 31, 2002 and \$37.1 million in the nine months ended December 31, 2001.

We had a net shares settled forward contract outstanding as of December 31, 2001. In connection with this contract, we made a net delivery of 572,645 shares of our common stock during the nine months ended December 31, 2001. We closed out the net shares settled forward contract in its entirety on January 15, 2002 and made a cash payment of \$27.8 million to purchase the remaining 1,610,606 shares outstanding under the contract. The purchased shares were held as treasury shares and used to fund stock option exercises and purchases under our employee stock purchase plan through April 9, 2002.

We believe that our existing sources of liquidity combined with cash generated from operations will be sufficient to meet our currently anticipated cash requirements for at least the next 12 months. However, the semiconductor industry is capital intensive. In order to remain competitive, we must constantly evaluate the need to make significant investments in capital equipment for both production and research and development. We may seek additional equity or debt financing during the next 12 months for the capital expenditures required to maintain or expand our wafer fabrication and product assembly and test facilities, or other purposes. The timing and amount of any such financing requirements will depend on a number of factors, including demand for our products, changes in industry conditions, product mix, and competitive factors. There can be no assurance that such financing will be available on acceptable terms, and any additional equity financing would result in incremental dilution to existing stockholders.

#### *Additional Factors That May Affect Our Results of Operations*

When evaluating Microchip and its business, you should give careful consideration to the factors listed below, in addition to the information provided elsewhere in this Form 10-Q and in other documents that we file with the Securities and Exchange Commission.

*Our quarterly operating results may fluctuate due to factors that could reduce our net sales and profitability.*

Our quarterly operating results are affected by a wide variety of factors that could reduce our net sales and profitability, many of which are beyond our control. Some of the factors that may affect our quarterly operating results include:

- demand for our products in the distribution and OEM channels
- the level at which previous design wins become actual orders and sales
- the level of sell-through of our products through distribution
- the level of orders that are received and can be shipped in a quarter (turns orders)
- market acceptance of both our products and our customers' products
- customer order patterns and seasonality
- downward pricing pressures in our non-proprietary product lines
- possible disruption in commercial activities or international transport or delivery caused by terrorist activity, armed conflict, war or unexpected increases in the price of, or decrease in the supply of, oil, any of which could result in changes in logistics and security arrangements, and reduced customer purchases relative to expectations
- possible disruptions to our customers' operations occasioned by any slow down or cessation in international transport or delivery caused by labor strikes or work stoppages at international ports of delivery in the United States or elsewhere which could result in reduced customer purchases relative to our expectations
- impact of events outside of the United States, such as the business impact of fluctuating currency rates or unrest or political instability
- disruption in the supply of wafers or assembly and testing services
- availability of manufacturing capacity, the extent of effective use of manufacturing capacity and fluctuations in manufacturing yields
- the availability and cost of raw materials, equipment and other supplies
- the costs and outcome of any litigation involving intellectual property, customer and other issues
- uninsured losses, and
- economic, political and other conditions in the worldwide markets served by us.

We believe that period-to-period comparisons of our operating results are not necessarily meaningful and that you should not rely upon any such comparisons as indications of future performance. In future periods our operating results may fall below the expectations of public market analysts and investors, which would likely have a negative effect on the price of our common stock.

*Our operating results will suffer if we ineffectively utilize our manufacturing capacity or fail to maintain manufacturing yields.*

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used and the performance of our wafer fabrication personnel and equipment. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at approximately the current levels.

Our operating results are also adversely affected when we operate at less than optimal capacity as was the case throughout fiscal 2002. Lower capacity utilization results in certain costs being charged directly to expense and lower gross margins.

*If we do not bring our Fab 4 (Gresham, Oregon) wafer fabrication facility on line in a timely manner, our anticipated revenues may be reduced and we would incur fixed expenses that would reduce our gross margins in future periods.*

On August 23, 2002, we acquired a semiconductor facility in Gresham, Oregon, which we refer to as Fab 4. We currently anticipate that Fab 4 will commence production in the second quarter of fiscal 2004. Bringing Fab 4 on-line involves significant risks, including:

- successful implementation of our 0.5 micron manufacturing process at Fab 4
- effective integration of a variety of hardware and software components
- potential shortages of materials and skilled labor
- unforeseen environmental or engineering problems
- approvals and requirements of governmental and regulatory agencies, and
- unanticipated costs.

Any one of these risks could delay the equipping and production start-up of Fab 4, and could involve significant additional costs or reduce our anticipated revenues.

As a result of these and other factors, Fab 4 may not commence production when anticipated or within budget. Also, we may be unable to achieve adequate manufacturing yields in Fab 4 in a timely manner and our revenues may not increase in proportion to the anticipated increase in manufacturing capacity associated with Fab 4 which would harm our operating results.

*We depend on orders that are received and shipped in the same quarter and therefore have limited visibility of future product shipments.*

Our net sales in any given quarter depend upon a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. We emphasize our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with short delivery schedules. Shorter lead times generally means that turns orders as a percentage of our business is relatively high in any particular quarter and reduces our visibility on future product shipments. The percentage of turns orders in any given quarter fluctuates and depends on overall semiconductor industry conditions and product lead times.

As such, our percentage of turns orders has fluctuated over the last three fiscal years between approximately 20% and 63%. At October 1, 2002, we required turns order of approximately 60% in order to achieve our revenue for the third quarter of fiscal 2003. Because turns orders are difficult to predict, increased levels of turns orders make our net sales more difficult to forecast.

If we do not achieve a sufficient level of turns orders in a particular quarter relative to our revenue targets, our revenue and operating results will suffer.

*Intense competition in our markets may lead to pricing pressures, reduced sales of our products and reduced market share.*

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources than we with which to pursue engineering, manufacturing, marketing and distribution of their products. Emerging companies are also increasing their participation in the market for embedded control applications. We may be unable to compete successfully in the future, which could harm our business.



Our ability to compete successfully depends on a number of factors both within and outside our control, including:

- the quality, performance, reliability, features, ease of use, pricing and diversity of our products
- the quality of our customer service and our ability to address the needs of our customers
- our success in designing and manufacturing new products including those implementing new technologies
- the rate at which customers incorporate our products into their own products
- our level of manufacturing capacity utilization and manufacturing yields
- our ability to hire and retain qualified engineering and management personnel
- product introductions by our competitors
- the number, nature and success of our competitors in a given market
- our ability to obtain adequate supplies of raw materials and other supplies at acceptable prices
- our ability to protect our products and processes by effective utilization of intellectual property laws, and
- general market and economic conditions.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller and proprietary analog and interface products have remained relatively constant, while average selling prices of our Serial EEPROM and non-proprietary analog and interface products have declined, over time. We have experienced, and expect to continue to experience, pricing pressure in certain of our proprietary product lines, due primarily to competitive conditions. We have been able to moderate average selling price declines in many of our proprietary product lines by continuing to introduce new products with more features and higher prices. We have experienced in the past and expect to continue to experience in the future varying degrees of competitive pricing pressures in our Serial EEPROM products.

We may be unable to maintain average selling prices for our products as a result of increased pricing pressure in the future, which would reduce our operating results.

*We must attract and retain qualified personnel to be successful, and competition for qualified personnel is intense in our market.*

Our success depends to a significant extent upon the efforts and abilities of our senior management, engineering and other personnel. The competition for qualified engineering and management personnel is intense. We may be unsuccessful in retaining our existing key personnel or in attracting and retaining additional key personnel that we require. The loss of the services of one or more of our key personnel or the inability to add key personnel could harm our business. We have no employment agreements with any member of our senior management team.

*Our success depends on our ability to introduce new products on a timely basis.*

Our future operating results will depend to a significant extent on our ability to develop and introduce new products on a timely basis that can compete effectively on the basis of price and performance and which address customer requirements. The success of new product introductions depends on various factors, including:

- proper new product selection
- timely completion and introduction of new product designs
- development of support tools and collateral literature that make complex new products easy for engineers to understand and use, and
- market acceptance of our customers' end products.

Because our products are complex, we have experienced delays from time to time in completing development of new products. In addition, our new products may not receive or maintain substantial market acceptance. We may be unable to design, develop and introduce competitive products on a timely basis, which could reduce our future operating results.

Our success also depends upon our ability to develop and implement new design and process technologies. Semiconductor design and process technologies are subject to rapid technological change and require significant R&D expenditures. We and other companies in the industry have, from time to time, experienced difficulties in effecting transitions to advanced process technologies and, consequently, have suffered reduced manufacturing yields or delays in product deliveries. Our future operating results could be adversely affected if any transition to future process technologies is substantially delayed or inefficiently implemented.

*General conditions in the insurance industry may affect our costs and increase the risks to our business operations.*

As conditions in the insurance industry have resulted in decreased availability of coverage and increased insurance rates over the last two fiscal years, our liability, property and casualty insurance coverage levels have decreased and our retained risk exposure from uninsured losses has increased. We have not made any material change to our operations as a result of the reduced coverage. Availability and cost of insurance coverage have generally fluctuated over time as the insurance industry reacts to various market forces and we will consider changes in our coverage levels based on conditions in the insurance market.

*We contract with several third-party contractors in Asia to perform key manufacturing functions for us.*

We use several third-party contractors located throughout Asia for a portion of the assembly and testing of our products and for a portion of the wafer fabrication of our analog products. Although we have reduced our dependence on third-party contractors over time, the disruption or termination of any of these sources could harm our business and operating results. Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. Our future operating results could suffer if any third-party contractor were to experience financial, operations or production difficulties, or if they were unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.

*We may lose sales if our suppliers of raw materials and equipment fail to meet our needs.*

Our semiconductor manufacturing operations require raw materials and equipment that must meet exacting standards. We generally have more than one source for these supplies, but there are only a limited number of suppliers capable of delivering various raw materials and equipment that meet our standards. In addition, the raw materials and equipment necessary for our business could become more difficult to obtain as worldwide use of semiconductors in product applications increases. We have experienced supply shortages from time to time in the past, and on occasion our suppliers have told us they need more time than expected to fill our orders or that they will no longer support certain equipment with updates or spare and replacements parts. An interruption of any raw materials or equipment sources, or the lack of supplier support for a particular piece of equipment, could harm our business.

*Our business is highly dependent on selling through distributors.*

Sales through distributors accounted for 63% of our net sales for the fiscal year ended March 31, 2002 and 59% of sales in the first nine months of fiscal 2003. Sales through one distributor accounted for 13% of our net sales in fiscal 2002 and 11% of our total net sales for the first nine months of fiscal 2003. Generally, we do not have long-term agreements with our distributors, and we or our distributors may terminate their relationship with us with little or no advanced notice.

The loss of, or a disruption in the operations of, one or more of our distributors could reduce our net sales in a given quarter and could result in an increase in inventory returns.

*Our operating results may be impacted by the wide fluctuations of supply and demand in the semiconductor industry.*

The semiconductor industry is characterized by wide fluctuations of supply and demand. Throughout fiscal 2001 and fiscal 2002, the industry experienced a significant economic downturn, characterized by diminished product demand and production over-capacity. These conditions continued during the first nine months of fiscal 2003. We have sought to reduce our exposure to this industry cyclicality by selling proprietary products, that cannot be easily or quickly replaced, to a geographically diverse base of customers across a broad range of market segments. However, we have experienced substantial period-to-period fluctuations in operating results and may, in the future, experience period-to-period fluctuations in operating results due to general industry or economic conditions.

*Intellectual property claims and litigation could subject us to significant liability for damages and could invalidate our proprietary rights.*

As is typical in the semiconductor industry, we and our customers have from time to time received, and may in the future receive, communications from third parties asserting patent or other intellectual property rights on certain of our products or technologies. In the event a third party were to make a valid intellectual property claim and a license or other agreement was not available on commercially reasonable terms, our operating results could be harmed. We have in the past been, are currently, and may in the future be, involved in litigation to defend Microchip against alleged infringement of the rights of others or to enforce our intellectual property rights. Litigation could result in substantial cost to us and divert our resources. An unfavorable outcome in any such suit could harm our business, financial condition or results of operations.

Our ability to obtain patents, licenses and other intellectual property rights covering our products and manufacturing processes is important for our success. To that end, we have acquired certain patents and patent licenses and intend to continue to seek patents on our inventions and manufacturing processes. The process of seeking patent protection can be long and expensive, and patents may not be issued from currently pending or future applications. In addition, our existing patents and any new patents that are issued may not be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. We may be subject to or may initiate interference proceedings in the U.S. Patent and Trademark Office, which can require significant financial and management resources. In addition, the laws of certain foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States.

*We do not have long-term contracts with our customers.*

We do not typically enter into long-term contracts with our customers and we cannot be certain as to future order levels from our customers. When we do enter into customer contracts, the contract is generally cancelable at the convenience of the customer. In the event of any early termination of a contract by one of our major customers, it is unlikely that we would be able to rapidly replace that revenue source which would harm our financial results.

*Business interruptions could harm our business.*

Operations at any of our primary manufacturing facilities, or at any of our wafer fabrication or test and assembly subcontractors, may be disrupted for reasons beyond our control, including work stoppages, power loss, incidents of terrorism, political instability, telecommunications failure, fire, earthquake, floods, or other natural disasters. If operations at any of our facilities or by any of our subcontractors are interrupted, we may not be able to shift production to other facilities on a timely basis. If this occurs, we may experience delays in shipments of products to our customers and alternate sources for production may be unavailable on acceptable terms. This

could result in reduced revenues and profits and the cancellation of orders or loss of customers. In addition, business interruption insurance will likely not be enough to compensate us for any losses that may occur and any losses or damages incurred by us as a result of business interruptions could significantly harm our business.

*We are highly dependent on foreign sales and operations, which exposes us to foreign political and economic risks.*

Sales to foreign customers account for a substantial portion of our net sales. During the fiscal year ended March 31, 2002, approximately 69% of our net sales were made to foreign customers. During the first nine months of fiscal 2003, approximately 71% of our net sales were made to foreign customers. We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own a product assembly and testing facility located near Bangkok, Thailand. We also use various third-party contractors located throughout Asia for a portion of the assembly and testing of our products and for a portion of the wafer fabrication of our analog products.

Our reliance on foreign operations, maintenance of substantially all of our finished goods in inventory at foreign locations and significant foreign sales exposes us to foreign political and economic risks, including:

- political, social and economic instability
- trade restrictions and changes in tariffs
- import and export license requirements and restrictions
- difficulties in staffing and managing international operations
- employment regulations
- disruptions in international transport or delivery
- fluctuations in currency exchange rates
- difficulties in collecting receivables
- economic slowdown in the worldwide markets served by us, and
- potentially adverse tax consequences.

If any of these risks materialize, our sales could decrease and our operating results could suffer.

*We are subject to stringent environmental regulation, which may force us to incur significant expenses.*

We must comply with many different federal, state and local governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing processes. Although we believe that our activities conform to presently applicable environmental regulations, our failure to comply with present or future regulations could result in the imposition of fines, suspension of production or a cessation of operations. Any such regulation could require us to acquire costly equipment or to incur other significant expenses to comply with environmental regulations. Any failure by us to control the use of or adequately restrict the discharge of hazardous substances could subject us to future liabilities. Environmental problems at our facilities may occur that could subject us to future costs or liabilities.

In 1993, TelCom Semiconductor, Inc., with whom we merged in January 2001, acquired the semiconductor manufacturing operations of Teledyne, Inc. previously conducted at TelCom's Mountain View, California facility. The semiconductor manufacturing operations conducted by Teledyne at the facility allegedly contaminated the soil and groundwater of the facility, and the groundwater of properties located down-gradient of the facility. Although TelCom was indemnified by Teledyne against, among other things, any liabilities arising from any such contamination, and although we should be able to benefit from this indemnification as a successor to TelCom's business, we cannot assure you that claims will not be made against us or that such indemnification will be available or will provide meaningful protection at the time any such claim is brought. To the extent that we are subject to a claim that is not covered by the indemnity from Teledyne or as to which Teledyne is unable to provide indemnification, our financial condition or operating results could suffer.

*Our failure to successfully integrate businesses, products or technologies we acquire could disrupt or harm our ongoing business.*

We have from time to time acquired, and may in the future acquire, additional complementary businesses, products and technologies. Achieving the anticipated benefits of an acquisition depends upon whether the integration of the acquired business, products or technology is accomplished efficiently and effectively. In addition, successful acquisitions in the semiconductor industry may be more difficult to accomplish than in other industries because such acquisitions require, among other things, integration of product offerings, manufacturing operations and coordination of sales and marketing and R&D efforts. These difficulties can become more challenging due to the need to coordinate geographically separated organizations, the complexities of the technologies being integrated, and the necessities of integrating personnel with disparate business backgrounds and combining two different corporate cultures. The integration of operations following an acquisition also requires the dedication of management resources, which may distract attention from our day-to-day business and may disrupt key R&D, marketing or sales efforts. The inability of our management to successfully integrate any future acquisition could harm our business. Furthermore, products acquired in connection with acquisitions may not gain acceptance in our markets, and we may not achieve the anticipated or desired benefits of such transaction.

*PowerSmart, Inc., which we acquired on June 5, 2002, depended on third-party wafer manufacturers for all of its product requirements. Any inability or unwillingness of PowerSmart's wafer suppliers to meet these manufacturing requirements would significantly delay our ability to produce and ship PowerSmart products.*

While Microchip has historically manufactured virtually all of its own wafers, PowerSmart purchased its wafers primarily from two outside foundries. Each of these foundries also fabricates wafers for other semiconductor companies, including some of our competitors. We expect to continue to rely on one outside foundry to supply a substantial portion of the wafers that are required to support the PowerSmart business through the first half of fiscal 2004. Such foundry is a direct competitor of ours. We may be unable to acquire wafers from this foundry if it experiences manufacturing failures, yield shortfalls or other situations when demand exceeds capacity or for other reasons. In such case, we may not be able to qualify additional manufacturing sources for existing PowerSmart products on a timely manner or at all, and such arrangements, if any, may not be on favorable terms to us.

Although current market conditions in the semiconductor industry indicate that there is sufficient manufacturing capacity at outside foundries, a significant increase in demand for PowerSmart products during the remainder of fiscal 2003 or the first half of fiscal 2004 could result in wafers being in short supply and prevent us from having an adequate supply to meet our customer requirements and meet requested delivery dates for customers of our PowerSmart products.

*Recently enacted and proposed changes in securities laws and related regulations could result in increased costs to us.*

Recently enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules proposed by the SEC, Nasdaq and the NYSE, could result in increased costs to us as we evaluate the implications of any new rules and respond to their requirements. The new rules could make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. In this regard, during the recent annual renewal of our director and officer liability insurance policy, we experienced substantially reduced policy limits and terms at a significant cost increase compared to our prior coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, on committees of our

board of directors, or as executive officers. We are presently evaluating and monitoring developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs.

*The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors.*

The market price of our common stock has fluctuated significantly in the past and is likely to fluctuate in the future. The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors, many of which are beyond our control, including:

- quarterly variations in our operating results and the operating results of other technology companies
- actual or anticipated announcements of technical innovations or new products by us or our competitors
- changes in analysts' estimates of our financial performance or buy/sell recommendations
- general conditions in the semiconductor industry, and
- worldwide political, economic and financial conditions.

In addition, the stock market has experienced significant price and volume fluctuations that have particularly affected the market prices for many high technology companies and that often have been unrelated to the operating performance of such companies. These broad market fluctuations and other factors may harm the market price of our common stock.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our investment portfolio, consisting of fixed income securities, was \$186.2 million as of December 31, 2002, and \$247.6 million as of March 31, 2002. These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. If market rates were to increase immediately and uniformly by 10% from the levels of December 31, 2002 and March 31, 2002, the decline in the fair value of our investment portfolio would not be material. Additionally, we have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize an adverse impact on income or cash flows.

We have international operations and are thus subject to foreign currency rate fluctuations. To date, our exposure related to exchange rate volatility has not been significant. If the foreign currency rates fluctuate by 15% from the rates at December 31, 2002 and March 31, 2002, the effect on our financial position and results of operations would not be material.

During the normal course of our business, we are routinely subjected to a variety of market risks, examples of which include, but are not limited to, interest rate movements and foreign currency fluctuations, as we discuss in this Item 3, and collectability of accounts receivable. We constantly assess these risks and have established policies and procedures to protect against the adverse affects of these other potential exposures. Although we do not anticipate any material losses in these risk areas, no assurance can be made that material losses will not be incurred in these areas in the future.

We believe that our market risk, as discussed in this Item 3, has not materially changed from March 31, 2002.

#### **Item 4. CONTROLS AND PROCEDURES**

##### *Evaluation of Disclosure Controls and Procedures*

Our chief executive officer and our chief financial officer, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended) as of a date within 90 days of our filing of this quarterly report on Form 10-Q, referred to as the “Evaluation Date,” have concluded that, as of the Evaluation Date, our disclosure controls and procedures were adequate and effective to ensure the timely collection, evaluation and disclosure of information relating to us and our consolidated subsidiaries that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

##### *Changes in Internal Controls*

There were no significant changes in our internal controls or other factors that could significantly affect our internal controls subsequent to the Evaluation Date. No significant deficiencies or material weaknesses were identified in the evaluation of our internal controls and therefore no corrective actions have been taken.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. LEGAL PROCEEDINGS**

*Microchip Technology Incorporated v. U.S. Philips Corporation, et al. (District of Arizona, 01-CV-2090-PGR); U.S. Philips Corporation v. Atmel Corporation, et al. (Southern District of New York, 01-CV-9178-LAP).* As reported in our annual report on Form 10-K for the fiscal year ended March 31, 2002 and our quarterly reports on Form 10-Q for the quarters ended June 30, 2002 and September 30, 2002, on October 26, 2001, we filed an action in federal district court in Arizona for declaratory relief against U.S. Philips Corporation and Philips Electronics North America Corp. requesting that the Court declare, among other matters, that we do not infringe Philips’ U.S. Patent Nos. 4,689,740 and 5,559,502. We initiated legal action so that a determination could be made relating to the validity, enforceability and alleged infringement of, and our license to, the Philips’ patents. In response to our filing the declaratory judgment action in Arizona, Philips filed an action against us in federal district court in New York, alleging infringement of the ‘740 patent and seeking unspecified damages and injunctive relief. The Arizona court has agreed to retain jurisdiction, and the New York court recently agreed to transfer the case in that forum to Arizona. In response to this development, on December 16, 2002, Philips filed a demand for arbitration in Amsterdam with the International Chamber of Commerce. We will contend that Philips’ demand for arbitration is untimely, and intend to continue to litigate this matter vigorously. We currently believe that the outcome of this matter will not have a material adverse effect on our consolidated financial position or results of operations. However, the final outcome of this matter is inherently uncertain, and should the outcome be adverse to us, we may be required to pay damages and other expenses and may be subjected to injunctive relief. The litigation, even if resolved in our favor, may also result in diversion of management attention and significant legal fees.

#### **Item 6. EXHIBITS AND REPORTS ON FORM 8-K**

##### **(a) Exhibits.**

Exhibit 99.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002.
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## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### **MICROCHIP TECHNOLOGY INCORPORATED**

Date: February 7, 2003

By /s/ Gordon W. Parnell

Gordon W. Parnell

Vice President and Chief Financial Officer

(Duly Authorized Officer, and

Principal Financial and Accounting Officer)



## CERTIFICATION

I, Steve Sanghi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microchip Technology Incorporated;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 7, 2003

/s/ Steve Sanghi  
Steve Sanghi  
President and CEO

## CERTIFICATION

I, Gordon W. Parnell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microchip Technology Incorporated;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 7, 2003

/s/ Gordon W. Parnell  
Gordon W. Parnell  
Vice President and CFO

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Steve Sanghi, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Microchip Technology Incorporated on Form 10-Q for the quarterly period ended December 31, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Microchip Technology Incorporated.

By: /s/ Steve Sanghi  
Name: Steve Sanghi  
Title: President and Chief Executive Officer  
Date: February 7, 2003

I, Gordon W. Parnell, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Microchip Technology Incorporated on Form 10-Q for the quarterly period ended December 31, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Microchip Technology Incorporated.

By: /s/ Gordon W. Parnell  
Name: Gordon W. Parnell  
Title: Vice President and Chief Financial Officer  
Date: February 7, 2003