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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 September 30, 2004.

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)

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

Yes ☒ No ☐

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

Yes ☒ No ☐

Number of shares of common stock, \$.001 par value, outstanding as of October 25, 2004: **206,329,952 shares.**

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# MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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

(in thousands, except share amounts)

ASSETS	September 30, 2004	March 31, 2004
	(Unaudited)	(Note 1)
Cash and cash equivalents	\$ 75,225	\$ 105,334
Short-term investments	530,635	369,216
Accounts receivable, net	120,702	109,231
Inventories	89,915	94,514
Prepaid expenses	8,224	6,884
Deferred tax assets	89,023	126,046
Other current assets	<u>72,533</u>	<u>72,720</u>
Total current assets	986,257	883,945
Property, plant and equipment, net	663,141	689,206
Goodwill	32,346	32,346
Intangible assets, net	8,990	9,698
Other assets	<u>7,594</u>	<u>6,948</u>
Total assets	<u>\$ 1,698,328</u>	<u>\$ 1,622,143</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Short-term debt	\$ 42,275	\$ ---
Accounts payable	38,280	61,184
Accrued liabilities	111,407	124,051
Deferred income on shipments to distributors	<u>100,990</u>	<u>84,816</u>
Total current liabilities	292,952	270,051
Pension accrual	714	871
Deferred tax liability	24,747	30,704
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 208,556,546 and outstanding 206,139,833 shares at September 30, 2004; issued 208,556,546 and outstanding 206,589,038 shares at March 31, 2004.	206	207
Additional paid-in capital	544,956	558,354
Accumulated other comprehensive (loss) income	(1,173)	733
Retained earnings	899,811	813,307
Less shares of common stock held in treasury at cost; 2,416,713 shares at September 30, 2004 and 1,967,508 shares at March 31, 2004.	<u>(63,885)</u>	<u>(52,084)</u>
Net stockholders' equity	<u>1,379,915</u>	<u>1,320,517</u>
Total liabilities and stockholders' equity	<u>\$ 1,698,328</u>	<u>\$ 1,622,143</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 September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net sales	\$ 220,694	\$ 168,486	\$ 433,469	\$ 329,769
Cost of sales	94,317	77,292	185,633	183,054
Gross profit	126,377	91,194	247,836	146,715
Operating expenses:				
Research and development	23,318	21,148	46,599	42,430
Selling, general and administrative	28,008	22,452	55,232	44,567
Special charges	---	---	21,100	1,612
	51,326	43,600	122,931	88,609
Operating income	75,051	47,594	124,905	58,106
Other income (expense):				
Interest income	4,265	893	7,185	1,684
Interest expense	(207)	(62)	(343)	(116)
Other, net	421	36	1,386	373
Income before income taxes	79,530	48,461	133,133	60,047
Income tax provision	19,087	12,357	28,891	10,473
Net income	\$ 60,443	\$ 36,104	\$ 104,242	\$ 49,574
Basic net income per share:	\$ 0.29	\$ 0.18	\$ 0.50	\$ 0.24
Diluted net income per share:	\$ 0.29	\$ 0.17	\$ 0.49	\$ 0.23
Dividends declared per common share	\$ 0.046	\$ 0.024	\$ 0.086	\$ 0.048
Weighted average common shares outstanding	206,191	205,089	206,441	204,523
Weighted average common and potential common shares outstanding	211,403	212,578	212,089	211,200

See accompanying notes to condensed consolidated financial statements

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

(in thousands)  
(Unaudited)

	Six Months ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net income	\$ 104,242	\$ 49,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of fixed assets	(1,082)	(52)
Special charges:		
Accelerated depreciation - Fab 1	---	30,608
Fab 1 severance and shutdown charges	---	723
Special charges - operating expenses	---	1,545
Depreciation and amortization	60,841	55,091
Deferred income taxes	31,462	(6,847)
Tax benefit from exercise of stock options	9,045	11,158
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(11,471)	4,602
Decrease (increase) in inventory	4,599	(1,927)
Increase (decrease) in deferred income on shipments to distributors	16,174	(317)
Decrease in accounts payable and accrued liabilities	(26,889)	(430)
Change in other assets and liabilities	(1,956)	1,372
Net cash provided by operating activities	<u>184,965</u>	<u>145,100</u>
Cash flows from investing activities:		
Purchases of short-term investments	(479,068)	(397,167)
Sales and maturities of short-term investments	315,347	253,354
Investment in other assets	---	(700)
Proceeds from sale of assets	1,083	613
Capital expenditures	(34,060)	(21,185)
Net cash used in investing activities	<u>(196,698)</u>	<u>(165,085)</u>
Cash flows from financing activities:		
Payment of cash dividend	(17,739)	(9,812)
Repurchase of common stock	(65,122)	(2,513)
Proceeds from short-term borrowings	42,275	---
Proceeds from sale of common stock	22,210	22,863
Net cash (used in) provided by financing activities	<u>(18,376)</u>	<u>10,538</u>
Net decrease in cash and cash equivalents	(30,109)	(9,447)
Cash and cash equivalents at beginning of period	<u>105,334</u>	<u>53,909</u>
Cash and cash equivalents at end of period	<u>\$ 75,225</u>	<u>\$ 44,462</u>

See accompanying notes to condensed consolidated financial statements

**MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(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. We do not have any subsidiaries in which we do not own 100% of the outstanding stock.

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, 2004. The results of operations for the three and six months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending March 31, 2005 or for any other period.

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

**(2) Settlement with U.S. Philips Corporation**

The Company has reached an agreement with U.S. Philips Corporation and Philips Electronics North America Corp. (together "Philips") regarding patent license litigation with Philips which has been ongoing for the past several years. The agreement includes dismissal of the pending litigation and the cross-license of certain patents between Philips and the Company. The Company recorded a special charge of \$21.1 million in the quarter that ended June 30, 2004 associated with this matter. Pursuant to this cross-license, the Company will license certain of its patents related to 8-pin microcontrollers, and Philips will license its patents related to I<sup>2</sup>C serial communications, each on fully-paid up, non-royalty bearing worldwide licenses. The Company finalized and executed the definitive settlement agreement related to this matter and made the cash payment to Philips during the fiscal quarter ending September 30, 2004.

**(3) Stock-Based Compensation**

The Company grants stock options for a fixed number of shares to certain employees and directors with an exercise price equal to the fair market value of the shares at the date of grant. The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations, and, accordingly, recognizes no compensation expense for the stock option grants.

The following table represents the effect on net income and earnings per share (shown in thousands except for per share amounts) if the Company had applied the fair value based method and recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," to stock-based employee and director compensation. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option pricing model and amortized ratably to expense over the options' vesting periods. Because the estimated value is determined as of the date of grant, the actual value ultimately realized by the employee may be significantly different.

	Three Months ended September 30, 2004		September 30, 2003		Six Months Ended September 30, 2004		September 30, 2003	
Net income, as reported	\$	60,443	\$	36,104	\$	104,242	\$	49,574
Deduct: Total stock-based employee compensation expense determined under fair value methods for all awards, net of related tax effects		<u>7,819</u>		<u>8,351</u>		<u>15,265</u>		<u>17,957</u>
Pro forma net income	\$	<u>52,624</u>	\$	<u>27,753</u>	\$	<u>88,977</u>	\$	<u>31,617</u>
Net income per share:								
Basic as reported	\$	0.29	\$	0.18	\$	0.50	\$	0.24
Basic, pro forma	\$	0.26	\$	0.14	\$	0.43	\$	0.15
Diluted, as reported	\$	0.29	\$	0.17	\$	0.49	\$	0.23
Diluted, pro forma	\$	0.25	\$	0.13	\$	0.42	\$	0.15
Weighted average shares used in computation:								
Basic		206,191		205,089		206,441		204,523
Diluted		211,403		212,578		212,089		211,200

On October 13, 2004, the Financial Accounting Standards Board ("FASB") concluded that Statement 123R, Share-Based Payment, which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for interim or annual periods beginning after June 15, 2005. Statement 123R will negatively impact the Company's earnings, however, the Company has not completed an analysis of all of the differences between Statement 123R and SFAS No. 123.

#### (4) Short-Term Investments

The Company's short-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. Short-term investments consist of corporate and various government agency debt securities. Management classifies the Company's short-term investments as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in stockholders' equity. Realized gains and losses and declines in value judged to be other than temporary, if any, are included in operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary, results in an impairment in the fair value of the investment. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security. Dividend and interest income are recognized when earned. The cost of a security sold is calculated using the specific identification method. The following is a summary of available-for-sale securities at September 30, 2004 (amounts in thousands):

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government agency bonds	\$ 507,474	\$ ---	\$ (1,411)	\$ 506,063
Corporate preferred stock	20,925	---	---	20,925
Municipal bonds	<u>3,666</u>	<u>---</u>	<u>(19)</u>	<u>3,647</u>
	<u>\$ 532,065</u>	<u>\$ ---</u>	<u>\$ (1,430)</u>	<u>\$ 530,635</u>

During the three and six-month periods ended September 30, 2004 and September 30, 2003, the Company did not have any gross realized gains or losses on sales of available-for-sale securities

The amortized cost and estimated fair value of the available-for-sale securities at September 30, 2004, by maturity, are shown below (amounts in thousands). Expected maturities can differ from contractual maturities

because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations.

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale				
Due in one year or less	\$ 1,021	\$ ---	\$ (3)	\$ 1,018
Due after one year and through five years	510,119	---	(1,427)	508,692
Due after five years through ten years	---	---	---	---
Due after ten years	20,925	---	---	20,925
	<u>\$ 532,065</u>	<u>\$ ---</u>	<u>\$ (1,430)</u>	<u>\$ 530,635</u>

(5) **Accounts Receivable**

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

	September 30, 2004	March 31, 2004
Trade accounts receivable	\$ 120,171	\$ 111,548
Other	4,348	1,493
	<u>124,519</u>	<u>113,041</u>
Less allowance for doubtful accounts	3,817	3,810
	<u>\$ 120,702</u>	<u>\$ 109,231</u>

(6) **Inventories**

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

	September 30, 2004	March 31, 2004
Raw materials	\$ 6,311	\$ 9,169
Work in process	61,251	57,589
Finished goods	22,353	27,756
	<u>\$ 89,915</u>	<u>\$ 94,514</u>

Inventory impairment 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.

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

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

	September 30, 2004	March 31, 2004
Land	\$ 33,494	\$ 33,494
Building and building improvements	298,722	293,230
Machinery and equipment	913,807	852,087
Projects in process	97,378	145,070
	<u>1,343,401</u>	<u>1,323,881</u>
Less accumulated depreciation and amortization	680,260	634,675
	<u>\$ 663,141</u>	<u>\$ 689,206</u>



Depreciation and amortization expense attributed to property and equipment was \$60.8 million in the six months ended September 30, 2004 and \$55.1 million in the six months ended September 30, 2003. In addition to depreciation and amortization expense, accelerated depreciation charges of \$30.6 million in the period ended September 30, 2003, related to our Fab 1 shutdown, are included in cost of sales.

**(8) Short-term Debt**

The Company had short-term debt of \$42.3 million as of September 30, 2004. The short-term debt is a result of repurchase agreements that are in place with two of the Company's investment brokerages. The short-term debt is collateralized with \$45.1 million of the Company's short-term investments. The short-term debt had a weighted average interest rate of 1.87% as of September 30, 2004. The Company used these borrowings to fund the activity under its stock repurchase programs during the three months ended September 30, 2004.

**(9) Income Taxes**

The income tax provisions that the Company recorded in the six-month periods ended September 30, 2004 and September 30, 2003 were impacted by special charges. The following table displays the impact that the special charges had on the income tax provision that the Company recorded in each of these periods (amounts in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Income before income taxes	\$ 79,530	\$ 48,461	\$ 133,133	\$ 60,047
Special charges:				
Cost of sales associated with Fab 1 closure	---	---	---	31,755
Fab 1 and other charges	---	---	---	1,612
Philips settlement	---	---	21,100	---
Total special charges	---	---	21,100	33,367
Income before taxes excluding special charges	79,530	48,461	154,233	93,414
Effective tax rate	24.0%	25.5%	24.0%	25.5%
Income tax provision excluding effect of special charges	19,087	12,357	37,015	23,820
Tax expense of special charges at 38.5% and 40%, respectively	---	---	8,124	13,347
Income tax provision	<u>\$ 19,087</u>	<u>\$ 12,357</u>	<u>\$ 28,891</u>	<u>\$ 10,473</u>

The special charge incurred during the six-month period that ended September 30, 2004 was associated with a settlement with Philips regarding a litigation matter. Such charge was incurred in the U.S. and tax effected at the Company's applicable U.S. federal and state rate of 38.5%. The special charges incurred during the six-month period that ended September 30, 2003 were associated with the closure of Fab 1 and other restructuring charges which were incurred in the U.S. and tax effected at the Company's applicable U.S. federal and state tax rate of 40%.

**(10) Comprehensive Income (Loss)**

Comprehensive income (loss) consists of net income and net unrealized gains (losses) on available-for-sale investments. The components of other comprehensive income (loss) and related tax effects were as follows (amounts in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Change in unrealized gains (losses) on investments, net of tax of \$767 and \$396, respectively	<u>\$ 4,587</u>	<u>\$ ---</u>	<u>\$ (1,906)</u>	<u>\$ ---</u>

**(11) 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 September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net income	<u>\$ 60,443</u>	<u>\$ 36,104</u>	<u>\$ 104,242</u>	<u>\$ 49,574</u>
Weighted average common shares outstanding	206,191	205,089	206,441	204,523
Dilutive effect of stock options	<u>5,212</u>	<u>7,489</u>	<u>5,648</u>	<u>6,677</u>
Weighted average common and potential common shares outstanding	<u>211,403</u>	<u>212,578</u>	<u>212,089</u>	<u>211,200</u>
Basic net income per share	<u>\$ 0.29</u>	<u>\$ 0.18</u>	<u>\$ 0.50</u>	<u>\$ 0.24</u>
Diluted net income per share	<u>\$ 0.29</u>	<u>\$ 0.17</u>	<u>\$ 0.49</u>	<u>\$ 0.23</u>

**(12) Stock Repurchase**

On April 22, 2004, the Company announced that its Board of Directors had authorized the Company to purchase up to 2.5 million shares of its common stock in the open market or in privately negotiated transactions. During the three months ended September 30, 2004, the Company repurchased 1,682,600 shares of its common stock for \$44.3 million, of which \$2.0 million was not paid until October 2004 and is reflected in the September 30, 2004 accounts payable balance. During the six months ended September 30, 2004, the Company repurchased 2,135,900 shares of its common stock for \$56.5 million. During the three months ended June 30, 2004, the Company also paid an additional \$10.6 million to settle repurchases of common stock related to orders which were made at the end of the March 2004 quarter for which the settlement date was during the June 2004 quarter. As of September 30, 2004, all but 2,416,713 of the purchased shares had been reissued to fund stock option exercises and purchases under the Company's employee stock purchase plan. The timing and amount of future repurchases will depend upon market conditions and corporate considerations.

**(13) Dividends**

On October 28, 2002, the Company announced that its Board of Directors had approved and instituted a quarterly cash dividend on its common stock. A quarterly cash dividend of \$0.046 per share was paid on September 1, 2004 in the amount of \$9.5 million. A quarterly cash dividend of \$0.052 per share was declared on October 21, 2004 and will be paid on December 1, 2004 to shareholders of record as of November 15, 2004. The Company expects the December 1, 2004 payment of its quarterly cash dividend to be approximately \$10.7 million.

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

*Our Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "future," "intend" and similar expressions to identify forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth below and under "Additional Factors That May Affect Our Results of Operations," beginning at page 25. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement.*

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of Microchip's overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three and six months ended September 30, 2004 compared to the three and six months ended September 30, 2003. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

### **Strategy**

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on embedded control products, which include microcontrollers, high-performance linear and mixed signal devices, power management and thermal management devices, and complementary microperipheral products including interface devices, Serial EEPROMs, and our patented KEELOQ<sup>®</sup> security devices. We provide highly cost-effective embedded control products that also offer the advantages of small size, high performance, low voltage/power operation and ease of development, enabling timely and cost-effective embedded control product integration by our customers.

Our manufacturing operations include wafer fabrication and assembly and test. The ownership of our manufacturing resources is an important component of our business strategy, enabling us to maintain a high level of manufacturing control resulting in us being one of the lowest cost producers in the embedded control industry. By owning our wafer fabrication facilities and much of our assembly and test operations, and by employing proprietary statistical process control techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture the wafer manufacturing and a portion of the assembly and test profit margin.

We employ proprietary design and manufacturing processes in developing our embedded control products. We believe our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs. While many of our competitors develop and optimize separate processes for their logic and memory product lines, we use a common process technology for both microcontroller and non-volatile memory products. This allows us to more fully leverage our process research and development costs and to deliver new products to market more rapidly. Our engineers utilize advanced computer-aided design (CAD) tools and software to perform circuit design, simulation and layout, and our in-house photomask and wafer fabrication facilities enable us to rapidly verify design techniques by processing test wafers quickly and efficiently.

We are committed to continuing our investment in new and enhanced products, including development systems, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. Our current research and development activities focus on the

design of new 8-bit microcontrollers, 16-bit digital signal controllers, memory and mixed-signal products, ASSPs, new development systems, and software and application-specific software libraries. We are also developing new design and process technologies to achieve further cost reductions and performance improvements in existing products.

We market our products worldwide primarily through a network of direct sales personnel and distributors. Our distributors focus primarily on servicing the product and technical support requirements of a broad base of diverse customers. We believe that distributors provide an effective means of reaching this broad and diverse customer base. Our direct sales force focuses primarily on major strategic accounts in three geographical markets: the Americas, Europe and Asia. We currently maintain sales and support centers in major metropolitan areas in North America, Europe and Asia. We believe that a strong technical service presence is essential to the continued development of the embedded control market. Many of our field sales engineers (FSEs), field application engineers (FAEs), and sales management have technical degrees and have been previously employed in an engineering environment. We believe that the technical knowledge of our sales force is a key competitive advantage in the sale of our products. The primary mission of our FAE team is to provide technical assistance to strategic accounts and to conduct periodic training sessions for FSEs and distributor sales teams. FAEs also frequently conduct technical seminars in major cities around the world, and work closely with our distributors to provide technical assistance and end-user support.

## **Critical Accounting Policies and Estimates**

### *General*

Our discussion and analysis of Microchip's financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We review the accounting policies we use in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, inventories, income taxes, property plant and equipment, impairment of property, plant and equipment and assets held for sale and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. We review these estimates and judgments on an ongoing basis. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

### *Revenue Recognition*

We recognize revenue from product sales upon shipment to OEMs. We record reserves to cover the estimated returns from OEM customers, which have historically been less than 1.5% of the sales to these customers. To the extent rates of return change, our estimates for the reserves necessary to cover such returns would also change. Our distributors worldwide have broad rights to return products and price protection rights, so we defer revenue recognition until the distributor sells the product to their customers. We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to third-party distributors on the inventory that they have on hand at the date the price protection is offered. When we reduce the price of our products, it allows the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it has on hand as of the date of the price reduction. There is no revenue impact from the price protections. We also grant certain credits to our third-party distributors. The credits are granted to the distributors on specially identified pieces of the distributors' business to allow them to earn a competitive gross margin on the sale of our products to their end customers. The credits are on a per unit basis and are not given to the distributor until they provide documentation of the sale to their end customer. The effect of granting these credits establishes the net selling

price from us to our distributors for the product and results in the net revenue recognized by us when the product is sold by the distributors to their end customers. Upon shipment, amounts billed to distributors are included as accounts receivable, inventory is relieved, the sale is deferred and the gross margin is reflected as a current liability until the product is sold by the distributor to their customers.

### *Inventories*

Inventories are valued at the lower of cost or market using the first-in, first-out (FIFO) method. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment 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. In estimating our reserves for obsolescence, we primarily evaluate estimates of demand over a 12-month period and provide reserves for inventory on hand in excess of the estimated 12-month demand.

### *Income Taxes*

As part of the process of preparing our condensed 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 condensed consolidated balance sheet. We must then assess the likelihood that our deferred tax assets 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 it is "more likely than not" that our deferred tax assets 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 September 30, 2004, our gross deferred tax asset was \$89.0 million.

Various taxing authorities in the United States and other 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 these countries. 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 the ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

*The foregoing statements regarding the recoverability of our deferred tax asset and the adequacy of our tax reserves are forward-looking statements. Actual results could differ materially because of the following factors, among others: results of any current or future audit conducted by the various taxing authorities in the countries in which we do business; the level of our taxable income and whether our taxable income will be sufficient to realize the benefits available from our deferred tax assets; current and future tax laws and regulations; and taxation rates in geographic regions where we have significant operations.*

### *Property, Plant & Equipment*

Property, plant and equipment are stated at cost. Major renewals and improvements are capitalized, while maintenance and repairs are expensed when incurred. At September 30, 2004, the carrying value of our property and equipment totaled \$663.1 million, which represents 39.0% of our total assets. This carrying value reflects the application of our property and equipment accounting policies, which incorporate estimates, assumptions and judgments relative to the useful lives of our property and equipment. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets, which range from five to seven years on manufacturing equipment, ten to fifteen years on building improvements and approximately 30 years on buildings.

We began production activities at Fab 4 on October 31, 2003. We began to depreciate the Fab 4 assets as they were placed in service for production purposes. As of September 30, 2004, all of the buildings and supporting facilities were being depreciated as well as the manufacturing equipment that had been placed in service. All manufacturing equipment at Fab 4 and our other facilities that was not being used in production activities was maintained in projects in process and is not being depreciated until it is placed into service since management believes there will be no change to its utility from the present time until it is placed into productive service. The lives to be used for depreciating this equipment will be evaluated at such time as the assets are placed in service. We do not believe that the temporary idling of such assets has impaired the estimated life or carrying values of the underlying assets.

The estimates, assumptions and judgments we use in the application of our property and equipment policies reflect both historical experience and expectations regarding future industry conditions and operations. The use of different estimates, assumptions and judgments regarding the useful lives of our property and equipment and expectations regarding future industry conditions and operations, would likely result in materially different carrying values of assets and results of operations.

We do not currently hold title to the land on which our Thailand facility resides. The land is subject to a complex restructuring situation relating to the seller of the land. We have provided reserves that we estimate will be adequate to obtain full title. Such reserves are set at the estimated fair value of the land. However, timing of the resolution is difficult to predict and the ultimate amount to be paid could change.

#### *Impairment of Property, Plant and Equipment and Assets Held for Sale*

We assess whether indicators of impairment of long-lived assets are present. If such indicators are present, we determine whether the sum of the estimated undiscounted cash flows attributable to the assets in question is less than their carrying value. If less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by discounted future cash flows, appraisals or other methods. If the assets determined to be impaired are to be held and used, we recognize an impairment loss through a charge to our operating results to the extent the present value of anticipated net cash flows attributable to the asset are less than the asset's carrying value, which we depreciate over the remaining estimated useful life of the asset. We may incur impairment losses, or additional losses on already impaired assets, in future periods if factors influencing our estimates change.

#### *Litigation*

Our current estimated range of liability related to certain pending litigation is based on the probable loss of claims for which we can estimate the amount and range of loss. Recorded reserves were not significant at September 30, 2004.

Because of the uncertainties related to both the probability of loss and the amount and range of loss on our pending litigation, we are unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates. Revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

### **Results of Operations**

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net sales .....	100.0%	100.0%	100.0%	100.0%
Cost of sales .....	42.7%	45.9%	42.8%	55.5%
Gross profit .....	57.3%	54.1%	57.2%	44.5%
Research and development.....	10.6%	12.6%	10.8%	12.9%
Selling, general and administrative .....	12.7%	13.3%	12.7%	13.5%
Special charges.....	---	---	4.9%	0.5%
Operating income.....	34.0%	28.2%	28.8%	17.6%

### *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 September 30, 2004 were \$220.7 million, an increase of 3.7% from the previous quarter's sales of \$212.8 million, and an increase of 31.0% from net sales of \$168.5 million in the quarter ended September 30, 2003. Our net sales for the six months ended September 30, 2004 were \$433.5 million, an increase of 31.4% from net sales of \$329.8 million in the six months ended September 30, 2003. The increases in net sales in these periods resulted primarily from increased demand across all of our product lines. Average selling prices for our products were down approximately 4% and 6% for the three and six-month periods ended September 30, 2004 over the corresponding period of the previous fiscal year driven primarily by significant increases in the unit volume of our memory products which generally have lower average selling prices than our proprietary products. The number of units of our products sold were up approximately 36% and 41% for the three and six-month periods ended September 30, 2004 over the corresponding periods of the previous fiscal year. The average selling prices and the unit volumes of our sales are impacted by the mix of our products sold. Key factors in achieving the amount of net sales during the three and six-month periods ended September 30, 2004 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 products.

We recognize revenue from product sales upon shipment to OEMs. Under our shipping terms, legal title passes to the customer upon shipment from Microchip. We have no post shipment obligations. Distributors generally have broad rights to return products and price protection rights, so we defer revenue recognition until the distributors sell the product to their customers. Upon shipment, amounts billed to distributors are included in accounts receivable, inventory is relieved, the sale is deferred and the gross margin is reflected as a current liability until the product is sold by the distributors to their customers.

Sales by product line for the three and six months ended September 30, 2004 and September 30, 2003 were as follows (dollars in thousands):

	Three Months Ended September 30 (unaudited)				Six Months Ended September 30, (unaudited)			
	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>
Microcontrollers	\$ 176,316	79.9%	\$ 133,420	79.2%	\$ 343,007	79.1%	\$ 262,797	79.7%
Memory products	29,200	13.2%	22,614	13.4%	59,339	13.7%	42,757	13.0%
Analog and interface products	<u>15,178</u>	<u>6.9%</u>	<u>12,452</u>	<u>7.4%</u>	<u>31,123</u>	<u>7.2%</u>	<u>24,215</u>	<u>7.3%</u>
Total sales	<u>\$ 220,694</u>	<u>100.0%</u>	<u>\$ 168,486</u>	<u>100.0%</u>	<u>\$ 433,469</u>	<u>100.0%</u>	<u>\$ 329,769</u>	<u>100.0%</u>

### Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 79.9% of our total net sales for the three-month period ended September 30, 2004 and approximately 79.1% of our total net sales for the six-month period ended September 30, 2004 compared to approximately 79.2% of our total net sales for the three-month period ended September 30, 2003 and approximately 79.7% of our total net sales for the six-month period ended September 30, 2003.

Net sales of our microcontroller products increased approximately 32.2% in the three-month period ended September 30, 2004 and 30.5% in the six-month period ended September 30, 2004 compared to the three and six-month periods ended September 30, 2003. 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 on page 15 above. 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 13.2% of our total net sales for the three-month period ended September 30, 2004 and 13.7% of our net sales for the six-month period ended September 30, 2004 compared to approximately 13.4% of our total net sales for the three-month period ended September 30, 2003 and approximate 13.0% for the six-month period ended September 30, 2003.

Net sales of our memory products increased approximately 29.1% in the three-month period ended September 30, 2004 and 38.8% in the six-month period ended September 30, 2004 compared to the three and six-month periods ended September 30, 2003. These sales increases 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. We experienced modest pricing declines in our Serial EEPROM product lines during the first three quarters of fiscal 2004. In the fourth quarter of fiscal 2004 and the first half of fiscal 2005, pricing of our Serial EEPROM product lines were approximately flat. 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 6.9% of our total net sales for the three-month period ended September 30, 2004 and 7.2% of our total net sales for the six-month period ended September 30, 2004, compared to approximately 7.4% of our total net sales for the three-month period ended September 30, 2003 and 7.3% of our total net sales for the six-month period ended September 30, 2003.

Net sales of our analog and interface products increased approximately 21.9% in the three-month period ended September 30, 2004 and 28.5% in the six-month period ended September 30, 2004 compared to the three and six-month periods ended September 30, 2003. These sales increases were primarily due to increased demand for our analog and interface products in end markets, driven principally by market share gains and those factors described on page 15 above.

Analog and interface products can be proprietary or non-proprietary in nature. Currently, we consider more than half 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. 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 will 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 have emphasized 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 mean that turns orders as a percentage of our business are relatively high in any particular quarter and reduces our backlog visibility on future product shipments. Turns orders correlate to product lead times, which extended during the second half of fiscal 2004 for many of our products. During the first two quarters of fiscal 2005, product lead times stabilized at the approximate levels of the fourth quarter of fiscal 2004.

The percentage of turns orders in any given quarter is dependent on overall semiconductor industry conditions and product lead times. During the first three quarters of fiscal 2004, our turns orders were at the high end of the range that we have experienced over the last several years. However, as product lead times extended in the last half of fiscal 2004, we began to have improved visibility and a reduction in the percentage of turns orders required to meet our revenue targets. Although product lead times have stabilized in fiscal 2005, overall semiconductor industry conditions have resulted in customers not providing us with as much visibility and the percentage of turns orders has moderately increased.

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 and timing 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; our ability to ramp products into volume production; the effects of 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; 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; changes in product mix; and general industry, economic and political conditions.*

### Distribution

Distributors accounted for approximately 64% of our net sales in the three-month period ended September 30, 2004 and approximately 63% of our net sales in the three-month period ended September 30, 2003. Distributors accounted for approximately 65% of our net sales in the six-month period ended September 30, 2004 and approximately 64% of our net sales in the six-month period ended September 30, 2003.

Our two largest distributors together accounted for approximately 24% of our net sales in the three-month period ended September 30, 2004, and approximately 25% of our net sales in the six-month period ended September 30, 2004 and in the three and six-month periods ended September 30, 2003.

Generally, we do not have long-term agreements with our distributors and we, or our distributors, may terminate our relationships with each other 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.

At September 30, 2004, distributors were maintaining an average of approximately 2.5 months of inventory of our products. Over the past three fiscal years, the months of inventory maintained by our distributors have fluctuated between approximately 2.0 and 2.9 months. During the last semiconductor industry cycle, months of inventory at our distributors reached a high of approximately 3.3 months. Thus, inventory levels at our distributors are at moderately low levels compared to historical levels. Our distributors may change their inventory holding levels based on industry conditions, product lead times and other factors pertinent to their business. As we recognize revenue based on sell through for all of our distributors, we do not believe that inventory holding patterns at our distributors will materially impact our net sales. However, as lead times change in the future, our distributors' inventory holding patterns could potentially impact their sales of our products.

Distributors generally have broad-based rights to return product to us. As revenue on distributor shipments is not recognized until the distributors sell our product on to their end customers, distributor returns have no impact on revenue recognition.

We also grant certain credits to our third-party distributors and also offer these distributors price protection. The credits are granted to the distributors on specifically identified pieces of the distributors' business to allow them to earn a competitive gross margin on the sale of our products to their end customers. The credits are on a per unit basis and are not given to the distributor until they provide documentation of the sale to their end customer. The effect of granting these credits establishes the net selling price from us to our distributors for the products and results in the net revenue recognized by us when the product is sold by the distributors to their end customers.

We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to third-party distributors on the inventory that they have on hand at the date the price protection is offered. When we reduce the selling price of our products, it allows the distributors to claim a credit against its outstanding accounts receivables balances based on the new price of the inventory it has on hand as of the date of the price reduction. There is no revenue recognition impact from the price protection.

We do not offer material incentive programs to our third-party distributors.

*The foregoing statement regarding our belief that inventory holding patterns at our distributors will not materially impact our net sales is a forward-looking statement. Actual results could differ materially because of the following factors, among others: changes in demand for our products and the products of our customers; the level and timing at which previous design wins become actual orders and sales; inventory mix and timing of customer orders; customers' inventory levels, order patterns and seasonality; the impact on our business and customer order patterns due to major public health concerns; level of sell-through of our products through distribution in any particular fiscal period; 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; 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; and the financial condition of our customers.*

### Sales by Geography

Sales by geography for the three and six-month periods ended September 30, 2004 and 2003 were as follows (dollars in thousands):

	Three Months Ended September 30 (unaudited)				Six Months Ended September 30 (unaudited)			
	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>
Americas	\$ 63,968	29.0%	\$ 53,885	32.0%	\$ 126,092	29.1%	\$ 104,589	31.7%
Europe	59,532	27.0%	44,761	26.6%	119,618	27.6%	91,572	27.8%
Asia	<u>97,194</u>	<u>44.0%</u>	<u>69,840</u>	<u>41.4%</u>	<u>187,759</u>	<u>43.3%</u>	<u>133,608</u>	<u>40.5%</u>
Total sales	<u>\$ 220,694</u>	<u>100.0%</u>	<u>\$ 168,486</u>	<u>100.0%</u>	<u>\$ 433,469</u>	<u>100.0%</u>	<u>\$ 329,769</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 74% of our net sales in the three-month period ended September 30, 2004 and approximately 73% of our net sales in the six-month period ended September 30, 2004. Sales to foreign customers accounted for approximately 71% of our net sales in the three and six-month periods ending September 30, 2003. For the three and six-month periods ended September 30, 2004 and September 30, 2003, approximately 99% of our net sales were U.S. dollar denominated.

### *Gross Profit*

Our gross profit was \$126.4 million in the three months ended September 30, 2004, and \$91.2 million in the three months ended September 30, 2003. Our gross profit was \$247.8 million in the six months ended September 30, 2004, and \$146.7 million in the six months ended September 30, 2003. Gross profit as a percent of sales was 57.3% in the three months ended September 30, 2004, and 54.1% in the three months ended September 30, 2003. Gross profit as a percent of sales was 57.2% in the six months ended September 30, 2004 and 44.5% in the six months ended September 30, 2003.

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

- \$31.8 million in accelerated depreciation and other costs associated with the closure of Fab 1 in the six-month period ended September 30, 2003;

- Improvements in capacity utilization and absorption of fixed costs which positively affected gross margin by \$2.5 million and \$3.9 million in the three and six-month periods ending September 30, 2004 over the corresponding period of the previous fiscal year;
- Decreases in other period cost of sales expenses in Fab 3 and Fab 4, such as start-up costs, which positively affect gross profit. Other period cost of sales expenses amounted to \$0.8 and \$1.6 million in the three and six-month periods ending September 30, 2004 and \$5.3 million and \$10.9 million in the three and six-month periods ending September 30, 2003; and
- A one-week shutdown in the three-month period ending September 30, 2003 negatively affecting gross profit by \$1.7 million. The shutdown had a negative impact on gross profit due to the fact that certain fixed costs including depreciation, utilities, property taxes and other ongoing costs continue when the factory is show down. There was not a similar shutdown in the current fiscal year.

Other factors that impacted gross profit percentage in the periods covered by this report include:

- continued cost reductions in wafer fabrication and assembly and test manufacturing such as new manufacturing technologies and more efficient manufacturing techniques;
- varying factors impacting the average selling prices of our products;
- fluctuations in the product mix of proprietary microcontroller and analog products and related Serial EEPROM products; and
- inventory write-offs and the sale of inventory that was previously written-off.

Excluding the impact of the one-week shutdown, capacity utilization in the second quarter of fiscal 2004 was approximately 91% at Fab 2. Capacity utilization in the second quarter of fiscal 2005 was approximately 97% at Fab 2, which favorably impacted gross margins. We began production at Fab 4 on October 31, 2003 and have ramped our production activities since that date. Our utilization of Fab 4's capacity is at relatively low levels, but will grow as our production activity increases at that location.

Fab 2 utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 to 1.0-micron processes. Fab 4 currently utilizes our 0.5-micron process technology. We continue to transition products to more advanced process technologies to reduce manufacturing costs. In the first quarter of fiscal 2004, approximately 80% of our production was on 8-inch wafers. Since the closure of Fab 1 at the end of the first quarter of fiscal 2004, all of our production has been on 8-inch wafers.

Our overall inventory levels were \$89.9 million at September 30, 2004, compared to \$94.5 million at March 31, 2004. We had 87 days of inventory on our balance sheet at September 30, 2004, compared to 101 days at March 31, 2004 and 123 days at September 30, 2003.

We anticipate that our 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, capacity utilization levels, particularly those at Fab 4, and competitive and economic conditions.

*The foregoing statements relating to our capacity growth at Fab 4, 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; absorption of fixed costs, labor and other direct manufacturing costs; competition and competitive pressure on pricing; 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; 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 September 30, 2004, approximately 69% of our assembly requirements were being performed in our Thailand facility, compared to approximately 74% as of September 30, 2003. 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 September 30, 2004 and September 30, 2003. During the first quarter of fiscal 2005, we substantially completed a 67,000 square expansion area at our Thailand facility that, once placed in service, will increase the facility's floor space for test capacity by approximately 80%. The expansion area is expected to be placed in service during fiscal 2005. 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.

#### *Research and Development (R&D)*

R&D expenses for the three months ended September 30, 2004 were \$23.3 million, or 10.6% of sales, compared to \$21.1 million, or 12.6% of sales, for the three months ended September 30, 2003. R&D expenses for the six months ended September 30, 2004 were \$46.6 million, or 10.8% of sales, compared to \$42.4 million, or 12.9% of sales for the six months ended September 30, 2003.

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 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 \$2.2 million, or 10.3%, for the three months ended September 30, 2004 over the same period last year. R&D expenses increased \$4.2 million, or 9.8%, for the six months ended September 30, 2004 over the same period last year. The primary reason for the increases in R&D costs in these periods was higher labor costs as a result of expanding our technical resources and increases in bonuses.

#### *Selling, General and Administrative*

Selling, general and administrative expenses for the three months ended September 30, 2004 were \$28.0 million, or 12.7% of sales, compared to \$22.5 million, or 13.3% of sales, for the three months ended September 30, 2003. Selling, general and administrative expenses for the six months ended September 30, 2004 were \$55.2 million, or 12.7% of sales, compared to \$44.6 million, or 13.5% of sales, for the six months ended September 30, 2003.

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 \$5.6 million, or 24.7%, for the three months ended September 30, 2004 over the same period last year. Selling, general and administrative expenses increased \$10.7 million, or 23.9%, for the six months ended September 30, 2004 over the same period last year. The

primary reasons for the increases in selling, general and administrative expenses in these periods were increases in labor costs as a result of expanding our internal resources and increases in bonuses and travel expenses.

Selling, general and administrative expenses fluctuate over time, primarily due to revenue and operating expense levels.

#### *Fab 1 Closure and Special Charges*

On April 7, 2003, we announced our intention to close our Chandler, Arizona (Fab 1) wafer fabrication facility and integrate certain Fab 1 personnel and processes into our Tempe, Arizona (Fab 2) wafer fabrication facility. We completed this integration process during the three-month period ended June 30, 2003. The closure of Fab 1 and the integration of certain Fab 1 personnel into Fab 2 operations resulted in a reduction in force of 207 employees who were either directly involved in our manufacturing operations or provided support to Fab 1. The detail of the charges incurred related to the closure of Fab 1 that were included in cost of sales for the three-month period ended June 30, 2003 is as follows (amounts in thousands):

Accelerated depreciation for Fab 1	\$ 30,608
Fab 1 related charges including severance, material and other costs	<u>1,147</u>
Total charges in cost of sales	<u>\$ 31,755</u>

For the quarter ended June 30, 2003, operating expense included \$1.6 million of special charges recorded principally for contract cancellation, severance and other costs related to the closure of Fab 1 and other actions. We incurred \$0.9 million of such expenditures during fiscal 2004. In the quarter ended December 31, 2003, we reversed \$0.7 million of the special charges recorded in the quarter ended June 30, 2003 as a result of a favorable outcome in the settlement of a contract cancellation.

The facility where Fab 1 is located is an integral part of our overall campus in Chandler, Arizona. Within this same facility resides our wafer probe, mask making and other manufacturing related activities. The accelerated depreciation that was taken only related to assets used in the wafer fabrication operations at the facility. We have no specific plans for utilizing the space formerly housing the wafer fabrication operations, and intend to leave it in an idle status. The property, plant and equipment that was subject to the accelerated depreciation is reflected in the gross and accumulated depreciation carrying values in the property, plant and equipment section of our balance sheet and related footnote disclosures.

#### *Settlement with U.S. Philips Corporation*

We reached an agreement with U.S. Philips Corporation and Philips Electronics North America Corp. (together "Philips") regarding patent license litigation between Philips and ourselves which had been ongoing for the past several years. The agreement includes dismissal of the pending litigation and the cross-license of certain patents between Philips and Microchip. We recorded a special charge of \$21.1 million in the quarter ended September 30, 2004 associated with this matter. As part of the settlement, we will license certain of our patents related to 8-pin microcontrollers, and Philips will license its patents related to I<sup>2</sup>C serial communications, each on fully-paid up, non-royalty bearing worldwide licenses. The definitive agreement related to this matter was finalized and executed and the cash payment was made by us to Philips during our fiscal quarter ending September 30, 2004.

#### *Other Income (Expense)*

Interest income increased in the three and six-month periods ended September 30, 2004 from the corresponding period of the previous fiscal year due to higher invested cash balances and higher interest rates being earned on these balances. Based on the higher cash balances we are carrying, we have extended the maturities of our short-term investments, which has resulted in a higher return, while not materially increasing the overall risk profile of our portfolio.

### *Provision (Benefit) for Income Taxes*

Provisions (benefits) for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings (losses). We had an effective tax rate of 21.7% for the six months ended September 30, 2004, impacted by the \$21.1 million special charge related to the Philips settlement which was tax effected at our applicable U.S. federal and state tax rate of 38.5%. We had an effective tax benefit rate of 17.4% for the six months ended September 30, 2003, impacted by \$33.4 million of special charges related to our closure of Fab 1 and other restructuring charges which were tax effected at our applicable U.S. federal and state tax rate of 40%. See Note 9 to our Condensed Consolidated Financial Statements for additional information on our effective tax rates.

At September 30, 2004, our gross deferred tax asset was \$89.0 million. Our gross deferred tax asset decreased by \$37.0 million in the six months ended September 30, 2004 compared to the balance at March 31, 2004, due primarily to increases in income allowing us to utilize tax credits and net operating losses and changes in various temporary differences between our book and tax reporting. At September 30, 2004, our gross deferred tax liability was \$24.7 million. Our gross deferred tax liability decreased by \$6.0 million in the six months ended September 30, 2004 compared to the balance at March 31, 2004, due primarily to changes in temporary differences in depreciation between our book and tax reporting.

Various taxing authorities in the United States and other countries in which we do business are increasing their scrutiny of various tax structures employed by businesses. 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 United States Internal Revenue Service for our fiscal years ended March 31, 1998, 1999, 2000 and 2001. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon audit in the United States and 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.

Our Thailand manufacturing operations currently benefit from numerous tax holidays that have been granted to us by the Thailand government based on our investments in property, plant and equipment in Thailand. Although our tax holidays in Thailand partially expired in October 2003, our manufacturing operations in Thailand are predominantly conducted using equipment that was invested pursuant to tax holidays that do not begin to expire until September 2006. The expiration of a portion of our tax holiday in Thailand in October 2003 did not have a material impact on our effective tax rate.

*The foregoing statement regarding the adequacy of our tax reserves to offset any potential tax liabilities that may arise upon audit is a forward-looking statement. 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.*

### *Liquidity and Capital Resources*

We had \$605.9 million in cash, cash equivalents and short-term investments at September 30, 2004, an increase of \$131.3 million from the March 31, 2004 balance. The increase in cash, cash equivalents and short-term investments over this time period is primarily attributable to cash generated from operating activities.

We maintain an unsecured short-term line of credit with various financial institutions in Asia totaling \$5.0 million (U.S. Dollar equivalent). There were no borrowings under the foreign line of credit as of September 30, 2004, but an allocation of approximately \$0.6 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.

During the six months ended September 30, 2004, we generated \$185.0 million of cash from operating activities, compared to \$145.1 million generated in the six months ended September 30, 2003. The increase in

cash flow from operations was primarily due to changes in profitability, deferred income taxes, accounts receivable, inventory balances, deferred income on shipments to distributors and accounts payable and accrued liabilities.

During the six months ended September 30, 2004, net cash used in investing activities increased \$31.6 million, to \$196.7 million, from \$165.1 million for the six months ended September 30, 2003. The increase was due to changes in our net purchases, sales and maturities of short-term investments in the six months ended September 30, 2004.

We enter into hedging transactions from time to time in an attempt to minimize our exposure to currency rate fluctuations. The amount of the hedges outstanding at September 30, 2004 were immaterial. 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.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the six months ended September 30, 2004 were \$34.1 million, compared to \$21.2 million for the six months ended September 30, 2003. The primary reasons for the dollar increase in capital expenditures in the three months ended September 30, 2004 were increases in our needs for additional manufacturing capacity due to increases in demand for our products. Capital expenditures are primarily for the expansion of production capacity and the addition of research and development equipment. We currently anticipate spending approximately \$75 million during the next 12 months to invest in equipment and facilities to maintain, and selectively increase, capacity to meet our currently anticipated needs.

We expect to finance capital expenditures through our existing cash balances and cash flows from operations. 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.

Net cash used in financing activities was \$18.4 million for the six months ended September 30, 2004. Net cash provided by financing activities was \$10.5 million for the six months ended September 30, 2003. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plan were \$22.2 million for the six months ended September 30, 2004 and \$22.9 million for the six months ended September 30, 2003. Cash expended for the repurchase of our common stock was \$65.1 million in the six months ended September 30, 2004 and \$2.5 million in the six months ended September 30, 2003. Proceeds from short-term borrowings were \$42.3 million in the six months ended September 30, 2004. We had no short-term borrowings during the six months ended September 30, 2003. We paid cash dividends to our shareholders in the six months ended September 30, 2004 of \$17.7 million and \$9.8 million in the six months ended September 30, 2003.

On March 11, 2004, our Board of Directors authorized the repurchase of 2.5 million shares of our common stock in the open market or in privately negotiated transactions. As of September 30, 2004, we had repurchased 2.5 million common shares under this authorization for a total of \$66.1 million. On April 22, 2004, our Board of Directors authorized the repurchase of an additional 2.5 million shares of our common stock in the open market or in privately negotiated transactions. As of September 30, 2004, we had repurchased 835,600 common shares under this authorization for a total of \$22.1 million. As of September 30, 2004, all but 2,416,713 of the purchased shares under the authorizations had been reissued to fund stock option exercises and purchases under our employee stock purchase plan.

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 \$4.0 million. We have continued to pay quarterly dividends and have increased the amount of such dividends on a regular basis. A quarterly dividend of \$0.046 per share was paid on September 1, 2004 in the amount of \$9.5 million. A quarterly cash dividend of \$0.052 per share was declared on October 21, 2004 and will be paid on December 1, 2004 to shareholders of record as of November 15, 2004. We expect the December 1, 2004 cash dividend to be approximately \$10.7 million. During the six-month period ended



September 30, 2004, we paid dividends in the amount of \$0.086 per share for a total dividend payment of \$17.7 million. During fiscal 2004, we paid dividends in the amount of \$0.113 per share for a total dividend payment of \$23.3 million.

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 from time to time to maintain or expand our wafer fabrication and product assembly and test facilities, or for 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 ownership dilution to our existing stockholders.

*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, 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 and our ability to meet our cash requirements 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 continuing to increase our production at Fab 4; 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; and the economic, political and other conditions in the worldwide markets served by us.*

#### *Contractual Obligations*

There have not been any material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the year ended March 31, 2004.

#### *Off-Balance Sheet Arrangements*

We do not have any transactions, arrangements or other relationships with unconsolidated entities that are reasonably likely to affect our liquidity or capital resources. We have no special purpose or limited purpose entities that provided off-balance sheet financing, liquidity or market or credit risk support, engage in leasing, hedging, research and development services, or other relationships that expose us to liability that is not reflected on the face of our financial statements. We do have lease commitments for our non-manufacturing facilities and other minor equipment that we enter into in the normal course of business.

#### *Recently Issued Accounting Pronouncements*

On October 13, 2004, the FASB concluded that Statement 123R, Share-Based Payment, which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for interim or annual periods beginning after June 15, 2005. We are in the process of determining the impact this will have on our consolidated financial statements.

#### *Additional Factors That May Affect 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:

- changes in demand or market acceptance of our products and products of our customers;
- the mix of inventory we hold and our ability to satisfy orders from our inventory;
- levels of inventories at our customers;
- changes in utilization of our manufacturing capacity and fluctuations in manufacturing yields;
- our ability to secure sufficient assembly and testing capacity;
- competitive developments including pricing pressures;
- the level of orders that are received and can be shipped in a quarter;
- the level of sell-through of our products through distribution;
- changes or fluctuations in customer order patterns and seasonality;
- constrained availability from other electronic suppliers impacting our customers' ability to ship their products, which in turn may adversely impact our sales to those customers;
- costs and outcomes of any tax audits or any disputes involving intellectual property, customers or other issues;
- disruptions in our business or our customers' businesses due to terrorist activity, armed conflict, war, worldwide oil prices and supply, public health concerns or disruptions in the transportation system;
- property damage or other losses which are not covered by insurance; and
- general economic, industry or political conditions in the United States or internationally.

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 our public guidance or 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. Lower capacity utilization results in certain costs being charged directly to expense and lower gross margins.

*If we are unable to increase our production activities at our Fab 4 (Gresham, Oregon) wafer fabrication facility in an efficient and timely manner, our anticipated revenues and gross margins may be adversely impacted.*

We acquired Fab 4, located in Gresham, Oregon, in August 2002. Fab 4 commenced production on October 31, 2003. Bringing Fab 4 to higher levels of production involves significant risks, including:

- successful implementation of our manufacturing processes at Fab 4;
- potential shortages of materials and skilled labor;
- unforeseen environmental or engineering problems; and
- unanticipated costs.

Any of these risks could delay our ability to increase production at Fab 4, and could result in significant additional costs or reduce our anticipated revenues.

As a result of these and other factors, Fab 4 may not increase 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 are dependent on orders that are received and shipped in the same quarter and therefore we are limited in our 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 relatively short delivery schedules. Shorter lead times generally mean 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.

During the first three quarters of fiscal 2004, our turns orders were at the high end of the range that we have experienced over the last several years. However, as product lead times extended in the last half of fiscal 2004, we began to have improved visibility and a reduction in the percentage of turns orders required to meet our revenue targets. Although product lead times have stabilized in fiscal 2005, overall semiconductor industry conditions have resulted in customers not providing us with as much visibility and the percentage of turns orders has moderately increased. Because turns orders are difficult to predict, varying 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 the markets we serve may lead to pricing pressures, reduced sales of our products or 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 do 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;
- 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;
- 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 rights;
- the quality of our customer service and our ability to address the needs of our customers; 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 adversely impact our operating results.

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

Our success depends 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 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 our 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 adversely impact 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.

*We are dependent on several third-party contractors 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. We also rely on outside wafer foundries for a portion of the wafer fabrication of our analog and smart battery management 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 situations when demand exceeds capacity, or if they were unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels. In such case, we may not be able to qualify additional manufacturing sources for our products on a timely manner or at all, and such arrangements, if any, may not be on favorable terms to us.

*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. 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 64% of our net sales in fiscal 2004 and 65% of our net sales in the first two quarters of fiscal 2005. Our two largest distributors together accounted for approximately 25% of our net sales in fiscal 2004 and approximately 25% of our net sales in the first two quarters of fiscal 2005. We do not have long-term agreements with our distributors and our distributors may terminate their relationships 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 due to lower sell through by our distributors to their end customers and could result in an increase in product 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. The industry has experienced significant economic downturns, characterized by diminished product demand and production over-capacity. 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.

*We are exposed to various risks related to legal proceedings or claims.*

We have been, and in the future may be, involved in legal proceedings or claims regarding patent infringement, intellectual property rights, contracts and other matters. As is typical in the semiconductor industry, we receive notifications from customers who believe that we owe them indemnification or other obligations related to infringement claims made against the customers by third parties. These legal proceedings and claims, whether with or without merit, could result in substantial cost to us and divert our resources. If we are not able to resolve a claim, negotiate a settlement of a matter, obtain necessary licenses on commercially reasonable terms, and/or successfully prosecute or defend our position, our business, financial condition or results of operations could be harmed.

*Failure to adequately protect our intellectual property could result in lost revenue or market opportunities.*

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. Infringement of our intellectual property rights by a third party could result in uncompensated lost market and revenue opportunities for us.

*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 about 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 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, public health issues, telecommunications failure, fire, earthquake, floods, or other natural disasters. If operations at any of our, or our subcontractors', facilities 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 fiscal 2004, approximately 71% of our net sales were made to foreign customers. During the first two quarters of fiscal 2005, approximately 73% 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 product assembly and testing facilities located near Bangkok, Thailand. We also use various foreign third-party contractors for a portion of our assembly and testing and for a portion of our wafer fabrication requirements for our analog and smart battery management products. Substantially all of our finished goods inventory is maintained in Thailand.

Our reliance on foreign operations, foreign suppliers, 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

process. 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 environmental regulations could require us to acquire costly equipment or to incur other significant expenses to comply with such regulations. Any failure by us to control the use of or adequately restrict the discharge of hazardous substances could subject us to future liabilities. Other environmental problems may occur that could subject us to future costs or liabilities.

*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 recent rules enacted and proposed by the SEC, Nasdaq and the NYSE, are resulting in increased costs to us as we respond to their requirements. In particular, complying with the internal control audit requirements of Sarbanes-Oxley Section 404 is resulting in increased internal efforts and higher fees from our independent accounting firm. 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 and/or incur substantially higher costs to obtain the same or similar 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 cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs that we may incur as we implement these new and proposed rules.

*While we believe we currently have adequate internal control over financial reporting, we are required to evaluate our internal control under Section 404 of the Sarbane-Oxley Act of 2002 and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.*

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 10-K for the fiscal year ending March 31, 2005, we will be required to furnish a report by our management on our internal control over financial reporting. Such report will contain among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. Such report must also contain a statement that our auditors have issued an attestation report on management's assessment of such internal controls. Public Company Oversight Board Auditing Standard No. 2 provides the professional standards and related performance guidance for auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under Section 404.

While we currently believe our internal control over financial reporting is effective, we are still performing the system and process documentation and evaluation needed to comply with Section 404, which is both costly and challenging. During this process, if our management identifies one or more material weaknesses in our internal control over financial reporting, we will be unable to assert such internal control is effective. If we are unable to assert that our internal control over financial reporting is effective as of March 31, 2005 (or if our auditors are unable to attest that our management's report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our stock price.

While we currently anticipate being able to satisfy the requirements of Section 404 in a timely fashion, we cannot be certain as to the timing of completion of our evaluation, testing and any required remediation due in large part to the fact that there is no precedent available by which to measure compliance with the new Auditing Standard No. 2. If we are not able to comply with the requirements of Section 404 in a timely manner or if our auditors are not able to complete the procedures required by Auditing Standard No. 2 to support their attestation report, we would likely lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our stock price.

*Recent and proposed regulations related to equity compensation could adversely affect our ability to attract and retain key personnel.*

Since our inception, we have used stock options and other long-term equity incentives as a fundamental component of our employee compensation packages. We believe that stock options and other long-term equity incentives directly motivate our employees to maximize long-term stockholder value and, through the use of vesting, encourage employees to remain with Microchip. On October 13, 2004, the Financial Accounting Standards Board (FASB) concluded that Statement 123R, Share-Based Payment, which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for interim or annual periods beginning after June 15, 2004. Statement 123R will negatively impact our earnings, however, we have not completed an analysis of all the differences between Statement 123R and SFAS No. 123, "Accounting for Stock-Based Compensation." Recording a charge for employee stock options under SFAS No. 123 would have decreased our net income by \$36.8 million in fiscal 2004 and by \$15.3 million in the first half of fiscal 2005. See also Note 3 to the Condensed Consolidated Financial Statements: Stock Based Compensation. In addition, new regulations implemented by The Nasdaq Stock Market requiring shareholder approval for all stock option plans as well as new regulations implemented by the NYSE prohibiting NYSE member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given voting instructions could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant options to employees, we may incur compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

*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;
- changes in our financial guidance or our failure to meet such guidance;
- general conditions in the semiconductor industry; and
- worldwide 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 that we hold on an available-for-sale basis, was \$592.5 million as of September 30, 2004. These securities, like all fixed income instruments, are subject to interest rate and credit risk and will decline in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize any material adverse impact in income or cash flows if market interest rates increase. The following table provides information about our available-for-sale securities that are sensitive to changes in interest rates. We have aggregated our available-for-sale securities for presentation purposes since they are all very similar in nature (dollars in thousands):



	Financial instruments mature during the fiscal year ended March 31,					
	2005	2006	2007	2008	2009	Thereafter
Available-for-sale securities	\$ ---	\$ 49,850	\$ 78,276	\$ 83,553	\$ 173,037	\$ 145,919
Weighted-average yield rate	---	2.18%	2.32%	3.15%	3.50%	3.78%

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. Approximately 99% of our sales are denominated in U.S. dollars. At times we maintain hedges of foreign currency exposure of a net investment in a foreign operation. The amounts of the hedges outstanding as of September 30, 2004 were immaterial. If foreign currency rates fluctuate by 15% from the rates at September 30, 2004, the effect on our financial position and results of operation would not be material.

During the normal course of 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 continuously assess these risks and have established policies and procedures to protect against the adverse effects of these and 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.

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

Our Chief Executive Officer and Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of September 30, 2004, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. During the three months ended September 30, 2004, there was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Part II. OTHER INFORMATION

### Item 1. Legal Proceedings

We reached an agreement with U.S. Philips Corporation and Philips Electronics North America Corp. (together “Philips”) regarding patent license litigation with Philips which has been ongoing for the past several years. The agreement includes dismissal of the pending litigation and the cross-license of certain patents between Philips and ourselves. We recorded a special charge of \$21.1 million in the quarter that ended June 30, 2004 associated with this matter. Pursuant to this cross-license, we will license certain of our patents related to 8-pin microcontrollers, and Philips will license its patents related to I<sup>2</sup>C serial communications, each on fully-paid up, non-royalty bearing worldwide licenses. We finalized and executed the definitive settlement agreement related to this matter and made the cash payment to Philips during the fiscal quarter ending September 30, 2004.

In the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. Although the outcome of these actions is not presently determinable, we believe that the ultimate resolution of these matters will not harm our business. Litigation relating to the semiconductor industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth our purchases of our common stock in the second quarter of fiscal 2005 and the footnotes below the table designate the repurchase programs that the shares were purchased under:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Programs
July 1, 2004 – July 31, 2004	1,457,600	\$ 26.38	1,457,600(1)(2)	1,889,400
August 1, 2004 – August 31, 2004	---	---	---	1,664,400
September 1, 2004 – September 30, 2004	<u>225,000</u>	\$25.80	<u>225,000(2)</u>	1,664,400
Total	1,682,600		1,682,600	

- (1) On March 11, 2004, our Board of Directors authorized the repurchase of up to 2,500,000 shares of our common stock in the open market or privately negotiated transactions. During the second quarter of fiscal 2005, we repurchased the remaining 847,000 shares available for repurchase.
- (2) On April 22, 2004, our Board of Directors authorized the repurchase of up to 2,500,000 shares of our common stock in the open market or privately negotiated transactions. As of September 30, 2004, 1,664,400 shares of this authorization remained available to be purchased under this program. There is no expiration date associated with this authorization.

### Item 4. Submission of Matters to a Vote of Security Holders

- (a) We held our Annual Meeting of Stockholders on August 20, 2004.
- (b) Steve Sanghi, Albert J. Hugo-Martinez, L.B. Day, Matthew W. Chapman and Wade F. Meyercord were elected as directors at the Annual Meeting.
- (c) The results of the vote on the matters voted upon at the Annual Meeting were as follows:

(1) *Election of Directors:*

<u>Director</u>	<u>For</u>	<u>Withheld/Abstain</u>
Steve Sanghi	183,916,553	5,161,664
Albert J. Hugo-Martinez	183,093,565	5,984,652
L.B. Day	181,039,702	8,038,515
Matthew W. Chapman	175,175,678	13,902,539
Wade F. Meyercord	181,820,235	7,257,982

(2) *Approval of an amendment to our 1994 International Employee Stock Purchase Plan to increase the number of shares of common stock reserved for issuance under the Plan by 100,000 shares:*

<u>For</u>	<u>Against</u>	<u>Withheld/Abstain</u>	<u>Broker Non-Votes</u>
166,892,665	3,386,619	201,237	18,597,696

(3) *Approval of the Company's 2004 Equity Incentive Plan, including its material terms and performance goals, for purposes of Internal Revenue Code Section 162(m):*

<u>For</u>	<u>Against</u>	<u>Withheld/Abstain</u>	<u>Broker Non-Votes</u>
134,503,237	35,761,267	216,017	18,597,696

The foregoing matters are described in more detail in our definitive proxy statement dated July 9, 2004.

**Item 6. Exhibits.**

- |            |   |
|------------|---|
| Exhibit 31 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| Exhibit 32 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

## **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: November 3, 2004

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 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2004

/s/ Steve Sanghi

Steve Sanghi  
President and CEO

**CERTIFICATION**

I, Gordon Parnell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microchip Technology Incorporated;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2004

/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 September 30, 2004 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: November 3, 2004

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 September 30, 2004 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: November 3, 2004