
**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2003.

OR

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

For the transition period from _____ to _____.

Commission File Number: 0-21184

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

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

86-0629024
(IRS Employer
Identification No.)

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

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

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

Yes X No

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

Yes X No

Number of shares of common stock, \$.001 par value, outstanding as of February 6, 2004: **208,096,961 shares.**

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share amounts)

ASSETS

	December 31, 2003 (Unaudited)	March 31, 2003 (Note 1)
Cash and cash equivalents	\$ 58,174	\$ 53,909
Short-term investments	392,266	162,602
Accounts receivable, net	92,173	95,387
Inventories	96,175	102,344
Prepaid expenses	6,199	6,487
Deferred tax assets	121,994	116,481
Other current assets	71,760	71,899
Total current assets	<u>838,741</u>	<u>609,109</u>
Property, plant and equipment, net	693,678	767,933
Goodwill	32,346	32,346
Intangible assets, net	10,076	10,830
Other assets	<u>6,697</u>	<u>8,057</u>
Total assets	<u>\$ 1,581,538</u>	<u>\$ 1,428,275</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts payable	\$ 33,944	\$ 34,143
Accrued liabilities	122,748	109,999
Deferred income on shipments to distributors	76,852	70,988
Total current liabilities	<u>233,544</u>	<u>215,130</u>
Pension accrual	948	1,008
Deferred tax liability	26,453	33,188
Stockholders' equity:		
Preferred stock, \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding.	---	---
Common stock, \$.001 par value; authorized 450,000,000 shares; issued and outstanding 207,965,312 shares at December 31, 2003; issued 203,744,801 and outstanding 203,432,946 shares at March 31, 2003.	208	203
Additional paid-in capital	546,638	486,315
Retained earnings	773,747	699,366
Less shares of common stock held in treasury at cost; 311,855 shares at March 31, 2003.	---	(6,935)
Net stockholders' equity	<u>1,320,593</u>	<u>1,178,949</u>
Total liabilities and stockholders' equity	<u>\$ 1,581,538</u>	<u>\$ 1,428,275</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)

	<u>Three Months Ended December 31,</u>		<u>Nine Months Ended December 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net sales	\$ 177,967	\$ 167,474	\$ 507,736	\$ 491,796
Cost of sales	<u>80,948</u>	<u>74,580</u>	<u>264,002</u>	<u>226,235</u>
Gross profit	97,019	92,894	243,734	265,561
Operating expenses:				
Research and development	20,858	22,323	63,288	66,220
Selling, general and administrative	23,056	22,430	67,623	67,498
Special charges	<u>(747)</u>	<u>---</u>	<u>865</u>	<u>50,800</u>
	43,167	44,753	131,776	184,518
Operating income	53,852	48,141	111,958	81,043
Other income (expense):				
Interest income	1,185	681	2,869	3,155
Interest expense	(52)	(114)	(168)	(372)
Other, net	<u>(16)</u>	<u>(27)</u>	<u>357</u>	<u>160</u>
Income before income taxes	54,969	48,681	115,016	83,986
Income tax provision	<u>14,126</u>	<u>12,299</u>	<u>24,599</u>	<u>17,349</u>
Income before cumulative effect of change in accounting principle	40,843	36,382	90,417	66,637
Cumulative effect of change in accounting principle net of income tax benefit of \$6,645	<u>---</u>	<u>---</u>	<u>---</u>	<u>11,443</u>
Net income	<u>\$ 40,843</u>	<u>\$ 36,382</u>	<u>\$ 90,417</u>	<u>\$ 55,194</u>
Basic net income per share:				
Before cumulative effect of change in accounting principle	\$ 0.20	\$ 0.18	\$ 0.44	\$ 0.33
Cumulative effect of change in accounting principle	<u>---</u>	<u>---</u>	<u>---</u>	<u>(0.06)</u>
Net income	<u>\$ 0.20</u>	<u>\$ 0.18</u>	<u>\$ 0.44</u>	<u>\$ 0.27</u>
Diluted net income per share:				
Before cumulative effect of change in accounting principle	\$ 0.19	\$ 0.17	\$ 0.43	\$ 0.32
Cumulative effect of change in accounting principle	<u>---</u>	<u>---</u>	<u>---</u>	<u>(0.06)</u>
Net income	<u>\$ 0.19</u>	<u>\$ 0.17</u>	<u>\$ 0.43</u>	<u>\$ 0.26</u>
Dividends declared per common share	<u>\$ 0.030</u>	<u>\$ 0.020</u>	<u>\$ 0.078</u>	<u>\$ 0.020</u>
Weighted average common shares outstanding	<u>207,142</u>	<u>203,109</u>	<u>205,375</u>	<u>202,152</u>
Weighted average common and potential common shares outstanding	<u>215,344</u>	<u>210,929</u>	<u>212,386</u>	<u>210,484</u>

See accompanying notes to condensed consolidated financial statements

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

	Nine Months Ended December 31,	
	2003	2002
Cash flows from operating activities:		
Net income	\$ 90,417	\$ 55,194
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	250	45
Inventory write-offs	4,394	4,750
Provision for pension accrual	---	34
Loss on sale of fixed assets	23	---
Loss on write-down of fixed assets	---	2,146
Cumulative effect of change in accounting principle	---	11,443
Special charges:		
Accelerated depreciation – Fab 1	30,608	---
Fab 1 severance and shutdown charges	598	---
Special charges – operating expenses	645	---
In-process research and development	---	9,300
Fab 3 impairment charge	---	41,500
Depreciation and amortization	82,956	82,895
Deferred income taxes (benefit)	(12,248)	(25,560)
Tax benefit from exercise of stock options	26,049	17,417
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	2,964	(11,553)
Decrease (increase) in inventory	1,302	(9,597)
Increase in deferred income on shipments to distributors	5,864	9,212
Increase in accounts payable and accrued liabilities	12,425	21,820
Change in other assets and liabilities	1,717	(5,547)
Net cash provided by operating activities	<u>247,964</u>	<u>203,499</u>
Cash flows from investing activities:		
Purchases of short-term investments	(668,468)	(809,069)
Sales and maturities of short-term investments	438,804	766,224
Investment in other assets	(700)	---
Proceeds from sale of assets	1,150	---
Purchase of Fab 4	---	(184,717)
PowerSmart acquisition, net of cash acquired	---	(50,674)
Capital expenditures	(39,638)	(62,918)
Net cash used in investing activities	<u>(268,852)</u>	<u>(341,154)</u>
Cash flows from financing activities:		
Payment of cash dividend	(16,035)	(4,061)
Repurchase of common stock	(2,513)	(7,473)
Proceeds from sale of stock	43,701	23,928
Net cash provided by financing activities	<u>25,153</u>	<u>12,394</u>
Net increase (decrease) in cash and cash equivalents	4,265	(125,261)
Cash and cash equivalents at beginning of period	<u>53,909</u>	<u>173,597</u>
Cash and cash equivalents at end of period	<u>\$ 58,174</u>	<u>\$ 48,336</u>

See accompanying notes to condensed consolidated financial statements

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003

(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, 2003. The results of operations for the three and nine months ended December 31, 2003 are not necessarily indicative of the results that may be expected for the year ending March 31, 2004 or for any other period.

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

For the three and nine months ended December 31, 2003, the Company changed its accounting policy relating to amounts billed to customers for shipping and handling costs to be consistent with EITF 00-10, *Accounting for Shipping and Handling Fees and Costs*. As a result, the Company has reclassified amounts billed to customers for shipping and handling costs from a reduction of cost of sales to revenue. The amount of the reclassification was immaterial and had no impact on gross margin. Prior year amounts have not been reclassified, as these amounts were immaterial.

(2) Closure of Chandler, Arizona Wafer Fabrication Facility and Special Charges

On April 7, 2003, the Company announced its intention to close its Chandler, Arizona (Fab 1) wafer fabrication facility and integrate certain Fab 1 personnel and processes into its Tempe, Arizona (Fab 2) wafer fabrication facility. The Company 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 the Company's manufacturing operations or provided support functions 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 expenses included \$1,612,000 of special charges recorded principally for contract cancellation, severance and other costs related to the closure of Fab 1 and other actions. The Company incurred \$865,000 of such expenditures during the nine-month period ended December 31, 2003. The Company reversed \$747,000 of the special charges recorded in the quarter ended June 30, 2003 in the quarter ended December 31, 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 the Company's overall campus in Chandler, Arizona. Within this same facility resides the Company's 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. The Company has no specific plans for utilizing the space formerly housing the wafer fabrication operations, and intends 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 the Company's balance sheet and related footnote disclosures.

(3) Change in Accounting Principle

On March 18, 2003, the Company announced that it would change its revenue recognition policy relating to regional Asian distributors from Point of Purchase (POP), or when the Company ships product to these distributors, to Point of Sale (POS), or when those distributors sell the Company's products to their customers. Effective with the date of the change in accounting principle, the Company changed its operating procedures with the regional Asian distributors to allow for broad-based rights of return and price protection. These changes resulted in product return rights and protection from pricing changes that were not offered to the regional Asian distributors prior to the change. Effective with the date of the change, the regional Asian distributors were advised that they would be given price protection on their on-hand inventory balances if future pricing reductions were made and they were advised they would also be granted the right to return product. The change in accounting principle was preferable because: (i) it better reflects the substance of end customer demand for the Company's products, and better focuses the Company on, and allows investors to better understand, end user demand trends for its products; (ii) it provides uniformity in the revenue recognition policy of the Company; and (iii) this accounting method is consistent with many other companies in the semiconductor industry and provides greater comparability in the presentation of financial results among the Company and its peers. To implement the change in revenue recognition, the Company recorded a cumulative effect of change in accounting principle charge of \$11.4 million (net of income taxes of \$6.6 million) as of April 1, 2002. The amounts for the three and nine-month periods ended December 31, 2002 have been restated to reflect this change in accounting principle. This change decreased income before cumulative effect of change in accounting principle for the three and nine-month periods ended December 31, 2002, by \$655,000 (\$0.00 per share) and \$2,389,000 (\$0.01 per share), respectively.

(4) 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 or greater than 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:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Net income, as reported	\$ 40,843	\$ 36,382	\$ 90,417	\$ 55,194
Deduct: Total stock-based employee compensation expense determined under fair value methods for all awards, net of related tax effects	<u>9,051</u>	<u>9,147</u>	<u>24,768</u>	<u>27,232</u>
Pro forma net income	<u>\$ 31,792</u>	<u>\$ 27,235</u>	<u>\$ 65,649</u>	<u>\$ 27,962</u>
Net income per share:				
Basic as reported	\$ 0.20	\$ 0.18	\$ 0.44	\$ 0.27
Basic, pro forma	\$ 0.15	\$ 0.13	\$ 0.32	\$ 0.14
Diluted, as reported	\$ 0.19	\$ 0.17	\$ 0.43	\$ 0.26
Diluted, pro forma	\$ 0.15	\$ 0.13	\$ 0.31	\$ 0.13
Weighted average shares used in computation:				
Basic	207,142	203,109	205,375	202,152
Diluted	215,344	210,929	212,386	210,484

The effects of applying SFAS No.123 for providing pro forma disclosures may not be representative of the effects on reported net income for future periods until all options outstanding are included in the pro forma disclosures. For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options is amortized to expense ratably from the grant date through the final vest date of the option.

(5) 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. These investments are carried at cost, which approximates fair value. The following is a summary of available-for-sale securities (amounts in thousands):

	December 31, 2003	March 31, 2003
State student loan bonds	\$ 220,350	\$ 109,400
Corporate preferred stock	99,925	30,375
Bank certificates of deposit	40,444	15,500
Corporate bond	10,000	---
Government agency bonds	10,000	---
Taxable municipal bonds	4,000	---
Fixed rate annuity contracts	<u>7,547</u>	<u>7,327</u>
	<u>\$ 392,266</u>	<u>\$ 162,602</u>

During the periods covered by this report, 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 December 31, 2003, 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. At December 31, 2003, there was no difference in the cost and estimated fair value of the Company's available-for-sale securities given that the longer-term instruments have interest rate reset features that in most cases adjust to current market rates every 7 to 35 days.

	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	\$ ---	\$ ---
Due after one year and through five years	10,000	10,000
Due after five years through ten years	---	---
Due after ten years	<u>382,266</u>	<u>382,266</u>
	<u>\$ 392,266</u>	<u>\$ 392,266</u>

(6) Accounts Receivable

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

	December 31, 2003	March 31, 2003
Trade accounts receivable	\$ 95,966	\$ 98,418
Other	<u>90</u>	<u>737</u>
	96,056	99,155
Less allowance for doubtful accounts	<u>3,883</u>	<u>3,768</u>
	<u>\$ 92,173</u>	<u>\$ 95,387</u>

(7) Inventories

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

	December 31, 2003	March 31, 2003
Raw materials	\$ 8,240	\$ 9,571
Work in process	65,757	62,683
Finished goods	<u>22,178</u>	<u>30,090</u>
	<u>\$ 96,175</u>	<u>\$ 102,344</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.

(8) Property, Plant and Equipment

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

	December 31, 2003	March 31, 2003
Land	\$ 33,494	\$ 33,488
Building and building improvements	289,756	196,800
Machinery and equipment	836,274	767,322

Projects in process	<u>160,483</u>	<u>297,751</u>
	1,320,007	1,295,361
Less accumulated depreciation and amortization	<u>626,329</u>	<u>527,428</u>
	<u>\$ 693,678</u>	<u>\$ 767,933</u>

Depreciation and amortization expense attributed to property and equipment was \$83.0 million in the nine months ended December 31, 2003 and \$82.9 million in the nine months ended December 31, 2002. In addition to depreciation and amortization expense, accelerated depreciation charges of \$30.6 million in the period ended December 31, 2003, related to our Fab 1 shutdown, are included in cost of sales.

(9) Lines of Credit

The Company has an unsecured line of credit with various financial institutions in Asia for up to \$15,000,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in U.S. Dollars, bearing interest at the Singapore Interbank Offering Rate (SIBOR) of 1.4525% at December 31, 2003 plus 0.5% (average) and expiring on various dates through July 2004. There were no borrowings against this line of credit as of December 31, 2003, but an allocation of \$716,000 of the available line was made, relating to import guarantees associated with the Company's business in Thailand. There are no covenants relative to the foreign line of credit.

(10) Income Taxes

The income tax provision (benefit) that the Company recorded in the nine-month period ended December 31, 2003, and the three and nine-month periods ended December 31, 2002 were impacted by special charges. The following table displays the impact that the special charges had on the income tax provision (benefit) that the Company recorded in each of these periods (amounts in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Income before income taxes	\$ 54,969	\$ 48,681	\$ 115,016	\$ 83,986
Special charges:				
Cost of sales associated with:				
Fab 1 closure	---	---	31,755	---
Fab 1 and other charges	(747)	---	865	---
PowerSmart acquisition	---	---	---	9,300
Fab 3 impairment charge	---	---	---	41,500
Total special charges	(747)	---	32,620	50,800
Income before taxes excluding special charges	54,222	48,861	147,636	134,786
Effective tax rate	<u>25.5%</u>	<u>25.2%</u>	<u>25.5%</u>	<u>25.2%</u>
Income tax provision excluding effect of special charges	13,827	12,299	37,647	33,949
Tax (expense) benefit of special charges at 40%	<u>(299)</u>	<u>---</u>	<u>13,048</u>	<u>16,600</u>
Income tax provision	<u>\$ 14,126</u>	<u>\$ 12,299</u>	<u>\$ 24,599</u>	<u>\$ 17,349</u>

The special charges incurred during the three and nine-month periods ended December 31, 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%. The special charge incurred during the nine-month period ended December 31, 2002 that was associated with purchased in-process research and development provided the Company with no income tax benefit. The special charge incurred during the three and

nine-month periods ended December 31, 2002 that was associated with the Fab 3 impairment charge was incurred in the U.S. and tax effected at the Company's applicable U.S. federal and state tax rate of 40%.

(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 December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Net income	<u>\$ 40,843</u>	<u>\$ 36,382</u>	<u>\$ 90,417</u>	<u>\$ 55,194</u>
Weighted average common shares outstanding	207,142	203,109	205,375	202,152
Dilutive effect of stock options	<u>8,202</u>	<u>7,820</u>	<u>7,011</u>	<u>8,332</u>
Weighted average common and potential common shares outstanding	<u>215,344</u>	<u>210,929</u>	<u>212,386</u>	<u>210,484</u>
Basic net income per share	<u>\$ 0.20</u>	<u>\$ 0.18</u>	<u>\$ 0.44</u>	<u>\$ 0.27</u>
Diluted net income per share	<u>\$ 0.19</u>	<u>\$ 0.17</u>	<u>\$ 0.43</u>	<u>\$ 0.26</u>

(12) Stock Repurchase

On August 7, 2002, the Company's Board of Directors authorized the Company to repurchase up to 2,500,000 shares of its Common Stock in the open market or in privately negotiated transactions. During the three months ended December 31, 2003, the Company did not repurchase any of its shares. The Company has purchased 1,392,200 shares of its common stock for \$29,576,077 since the inception of the repurchase program. All of the purchased shares had been reissued as of December 31, 2003 through 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 \$0.03 per share was paid on December 1, 2003 in the amount of \$6,223,067. A quarterly cash dividend of \$0.035 per share was declared on January 22, 2004 and will be paid on March 5, 2004 to shareholders of record as of February 12, 2004. The Company expects the March 2004 payment of its quarterly cash dividend to be approximately \$7.3 million.

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

Business Conditions

During the last several years our customers have tended to only place orders with us for their very short-term product requirements. Customers were able to satisfy their product needs in this environment because we maintained very short lead times for many of our products, having the inventory in stock or available in 2 weeks or less. In the December 2003 quarter lead times for many of our products began to lengthen and the original customer requested dates for product deliveries became more difficult for us to meet. We also understand from our customers, distributors and other sources that lead times in the semiconductor industry in general are being extended. As a result of these factors, during the quarter ended December 31, 2003, we experienced certain changes in the ordering patterns of our customers and we ended the quarter with the highest backlog on our books entering a quarter since the December 2000 quarter. This strong order booking activity has continued into the March 2004 quarter. Our net sales in a quarter depend on a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. Although entering a quarter with higher backlog allows us to operate our factories more efficiently, turns orders are still a critical element to us in achieving our quarterly revenue targets.

Results of Operations

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	45.5%	44.5%	52.0%	46.0%
Gross profit	54.5%	55.5%	48.0%	54.0%
Research and development.....	11.7%	13.3%	12.4%	13.5%
Selling, general and administrative	12.9%	13.4%	13.3%	13.7%
Special charges.....	(0.4%)	---	0.2%	(10.3%)
Operating income.....	30.3%	28.7%	22.1%	16.5%

Net Sales

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

Our net sales for the quarter ended December 31, 2003 were \$178.0 million, an increase of 5.6% from the previous quarter's sales of \$168.5 million, and an increase of 6.3% from net sales of \$167.5 million in the quarter ended December 31, 2002. Our net sales for the nine months ended December 31, 2003 were \$507.7 million, an increase of 3.2% from net sales of \$491.8 million for the nine months ended December 31, 2002. The increases in net sales in these periods resulted primarily from increased demand for our proprietary microcontroller products. Average selling prices for our products were down approximately 11% and 8% for the three and nine-month periods ended December 31, 2003 over the corresponding periods of the previous fiscal year. The number of units of our products sold were up approximately 19% and 12% for the three and nine-month periods ended December 31, 2003 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 nine-month periods ended December 31, 2003 include:

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

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.

During the quarter ended December 31, 2003, we changed our accounting policy relating to amounts billed to customers for shipping and handling costs to be consistent with EITF 00-10. With this change, we have reclassified amounts billed to customers for shipping and handling costs from a reduction of cost of sales to revenue for the first three quarters of fiscal 2004. This reclassification had no impact on net income. Prior year amounts have not been reclassified, as these amounts were immaterial.

Sales by product line for the three and nine months ended December 31, 2003 and December 31, 2002 were as follows (dollars in thousands):

	Three Months Ended December 31 (unaudited)				Nine Months Ended December 31 (unaudited)			
	<u>2003</u>	<u>%</u>	<u>2002</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>2002</u>	<u>%</u>
Microcontrollers	\$141,531	79.5%	\$133,800	79.9%	\$404,571	79.7%	\$387,480	78.8%
Memory products	23,737	13.3	20,830	12.4	66,494	13.1	67,325	13.7
Analog and interface products	<u>12,699</u>	<u>7.2</u>	<u>12,844</u>	<u>7.7</u>	<u>36,671</u>	<u>7.2</u>	<u>36,991</u>	<u>7.5</u>
Total sales	<u>\$177,967</u>	<u>100.0%</u>	<u>\$167,474</u>	<u>100.0%</u>	<u>\$507,736</u>	<u>100.0%</u>	<u>\$491,796</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 79.5% of our total net sales for the three-month period ended December 31, 2003 and approximately 79.7% of our total net sales for the nine-month period ended December 31, 2003 compared to approximately 79.9% of our total net sales for the three-month period ended December 31, 2002, and 78.8% of our total net sales for the nine-month period ended December 31, 2002.

Net sales of our microcontroller products increased approximately 5.8% in the three-month period ended December 31, 2003 and 4.4% in the nine-month period ended December 31, 2003, compared to the three and nine-month periods ended December 31, 2002. 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 13 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 13.3% of our total net sales for the three-month period ended December 31, 2003 and approximately 13.1% of our total net sales for the nine-month period ended December 31, 2003 compared to approximately 12.4% of our total net sales for the three-month period ended December 31, 2002, and 13.7% of our total net sales in the nine-month period ended December 31, 2002.

Net sales of our memory products increased approximately 14.0% in the three-month period ended December 31, 2003, compared to the three-month period ended December 31, 2002. Net sales of our memory products decreased approximately 1.2% in the nine-month period ended December 31, 2003, compared to the nine-month period ended December 31, 2002. These changes in sales 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 fiscal 2003 and in the first three quarters of fiscal 2004. 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 7.2% of our total net sales for the three and nine-month periods ended December 31, 2003, compared to approximately 7.7% of our total net sales for the three-month period ended December 31, 2002, and 7.5% of our total net sales for the nine-month period ended December 31, 2002.

Net sales of our analog and interface products were approximately flat in the three and nine-month periods ended December 31, 2003 compared to the corresponding periods of the previous fiscal year. Our net sales of analog and interface products within the telecommunications sector, primarily in the cell phone market, were down approximately 33% in the three-month period ended December 31, 2003 and down approximately 41% in the nine-month period ended December 31, 2003, compared to the same periods in the prior years. In the nine-month period ended December 31, 2003, telecommunications represented approximately 16% of our sales of analog and interface products compared to approximately 29% in the nine-month period ended December 31, 2002. Our net sales of non-telecommunications analog and interface products were up approximately 29% in the three-month period ended December 31, 2003 and approximately 21% in the nine-month period ended December 31, 2003 compared to the same periods in the prior year primarily due to the sales synergies with our microcontroller products which we refer to as our “attach” strategy and increases in sales to other analog customers. Our primary focus for our analog and interface products continues to be our “attach” strategy where we sell our microcontrollers and analog products to the same customers.

Analog and interface products can be proprietary or non-proprietary in nature. Currently, we consider approximately 60% of our analog and interface product mix to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog and interface business will experience price fluctuations, driven primarily by the current supply and demand for those products. During the first three quarters of fiscal 2004, pricing of our non-proprietary analog and interface products moderately increased compared to prices at the end of fiscal 2003. During fiscal 2003, pricing of our non-proprietary analog and interface products was approximately flat compared to prices at the end of fiscal 2002. 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 have extended during the December 2003 and March 2004 quarters for many of our products, as discussed under Business Conditions above at page 12. With current lead times extending from their levels of the past several years for many of our products, customers are beginning to place orders with us extending beyond their immediate requirements.

The percentage of turns orders in any given quarter is dependent on overall semiconductor industry conditions and product lead times. During fiscal 2003 and 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.

Even with improved visibility, 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; the financial condition of our customers; fluctuations in production yields, production efficiencies and our overall capacity utilization; changes in product mix; absorption of fixed costs, labor and other fixed manufacturing costs; and general industry, economic and political conditions.

Distribution

Distributors accounted for approximately 63% of our net sales in the three-month period ended December 31, 2003 and 56% of our net sales in the three-month period ended December 31, 2002. Distributors accounted for approximately 63% of our net sales in the nine-month period ended December 31, 2003 and 58% of our net sales in the nine-month period ended December 31, 2002.

Our two largest distributors together accounted for approximately 24% of our net sales in the three and nine-month periods ended December 31, 2003 and approximately 19% of our net sales in the three-month period ended December 31, 2002 and approximately 20% in the nine-month period ended December 31, 2002.

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 December 31, 2003, distributors were maintaining an average of approximately 2.2 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 3.3 months. Thus, inventory levels at our distributors are at the low end of the range we have experienced over the last three years. 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 extend, 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 protections.

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

The foregoing statements regarding our belief that inventory holding patterns at our distributors will not materially impact our net sales 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; 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 nine-month periods ended December 31, 2003 and 2002 were as follows (dollars in thousands):

	Three Months Ended December 31 (unaudited)				Nine Months Ended December 31 (unaudited)			
	<u>2003</u>	<u>%</u>	<u>2002</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>2002</u>	<u>%</u>
Americas	\$57,051	32.1%	\$57,321	34.2%	\$161,640	31.8%	\$169,038	34.4%
Europe	46,205	26.0%	42,217	25.2%	137,777	27.2%	129,827	26.4%
Asia	<u>74,711</u>	<u>41.9%</u>	<u>67,936</u>	<u>40.6%</u>	<u>208,319</u>	<u>41.0%</u>	<u>192,931</u>	<u>39.2%</u>
Total sales	<u>\$177,967</u>	<u>100.0%</u>	<u>\$167,474</u>	<u>100.0%</u>	<u>\$507,736</u>	<u>100.0%</u>	<u>\$491,796</u>	<u>100.0%</u>

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

Sales to foreign customers accounted for approximately 71% of our net sales in three-month periods ended December 31, 2003 and December 31, 2002. Sales to foreign customers accounted for approximately 71% of our net sales in the nine months ended December 31, 2003 and approximately 70% of our net sales in the nine months ended December 31, 2002. For the nine-month periods ended December 31, 2003 and December 31, 2002, approximately 99% of our net sales were U.S. dollar denominated.

Gross Profit

Our gross profit was \$97.0 million in the three months ended December 31, 2003, and \$92.9 million in the three months ended December 31, 2002. Our gross profit was \$243.7 million in the nine months ended December 31, 2003, and \$265.6 million in the nine months ended December 31, 2002.

Gross profit as a percent of sales was 54.5% in the three months ended December 31, 2003, and 55.5% in the three months ended December 31, 2002. Gross profit as a percent of sales was 48.0% in the nine months ended December 31, 2003, and 54.0% in the nine months ended December 31, 2002.

The most significant factors affecting 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 nine-month period ended December 31, 2003
- Improvements in capacity utilization and product absorption which positively affected gross margin by \$1.5 million and \$13.1 million in the three and nine-month periods ending December 31, 2003 over the corresponding periods of the previous fiscal year
- Increases in expenses for Fab 3 and Fab 4, our non-operational facilities during the periods covered by this report, negatively affecting gross profit by \$3.2 million and \$10.2 million in the three and nine-month periods ending December 31, 2003 over the corresponding periods of the previous fiscal year
- A one-week unpaid shutdown in the nine-month period ending December 31, 2003 negatively affecting gross profit by \$1.7 million. The shutdown occurred in the three-month period ending September 30, 2003 and 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 shut down. There was not a similar shutdown in the corresponding period of the previous 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.

Capacity utilization in the third quarter of fiscal 2004 was approximately 92% at Fab 2. Capacity utilization in the third quarter of fiscal 2003 was approximately 86%. We expect capacity utilization in the fourth quarter of fiscal 2004 to be approximately 92% at Fab 2. We began production at Fab 4 on October 31, 2003 and our utilization of its capacity will be at low levels for the next several quarters but will grow as our production activity increases at that location.

The process technologies utilized and the size of the wafers on which our products are produced impact our gross margins. During the third quarter of fiscal 2004, Fab 2 predominantly utilized our 0.5 to 1.0-micron manufacturing process technologies. We expect Fab 2 to continue to predominantly utilize our 0.5 to 1.0-micron processes during the fourth quarter of fiscal 2004. During the third quarter of fiscal 2004, Fab 4 predominantly utilized our 0.5 micron process technology. We expect Fab 4 to predominantly utilize our 0.5 micron process during the fourth quarter of fiscal 2004. We continue to transition products to more advanced process technologies to reduce manufacturing costs. In fiscal 2003 and the first quarter of fiscal 2004, approximately 80% of our production was on 8-inch wafers. With the closure of Fab 1 in the first quarter of fiscal 2004, all of our future production in fiscal 2004 will be on 8-inch wafers.

Our overall inventory levels were \$96.2 million at December 31, 2003, compared to \$102.3 million at March 31, 2003. We had 108 days of inventory on our balance sheet at December 31, 2003, compared to 128 days at March 31, 2003 and 111 days at December 31, 2002. We expect inventory levels to fall for the remainder of fiscal 2004.

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, wafer fab loading levels, particularly those at Fab 4, and competitive and economic conditions.

The foregoing statements relating to our capacity utilization in the fourth quarter, our capacity growth at Fab 4, our transition to advanced process technologies to reduce future manufacturing costs, our future production of 8-inch wafers, our belief that inventory levels will decline for the remainder of fiscal 2004 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 December 31, 2003 and at December 31, 2002, approximately 80% of our assembly requirements were being performed in our Thailand facility. Third-party contractors located throughout Asia perform the balance of our assembly operations. Substantially all of our test requirements were being performed in our Thailand facility as of December 31, 2003 and December 31, 2002. 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 December 31, 2003 were \$20.9 million, or 11.7% of sales, compared to \$22.3 million, or 13.3% of sales, for the three months ended December 31, 2002. R&D expenses for the nine months ended December 31, 2003 were \$63.3 million, or 12.4% of sales, compared to \$66.2 million, or 13.5% of sales for the nine months ended December 31, 2002.

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

R&D expenses decreased \$1.5 million, or 6.6%, for the three months ended December 31, 2003 over the same period last year. R&D expenses decreased \$2.9 million, or 4.4%, for the nine months ended December 31, 2003 over the same period last year. The primary reasons for the decreases in R&D costs in these periods were lower labor costs, lower costs associated with product prototyping and minor reductions in several other expense areas.

Selling, General and Administrative

Selling, general and administrative expenses for the three months ended December 31, 2003 were \$23.1 million, or 12.9% of sales, compared to \$22.4 million, or 13.4% of sales, for the three months ended December 31, 2002. Selling, general and administrative expenses for the nine months ended December 31, 2003 were \$67.6 million, or 13.3% of sales, compared to \$67.5 million, or 13.7% of sales, for the nine months ended December 31, 2002.

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 use and proper selection of our products.

Selling, general and administrative expenses increased \$0.6 million, or 2.8%, for the three months ended December 31, 2003 over the same period last year. The primary reasons for the increase in selling, general and administrative expenses in this period were increases in labor and travel expenses. Selling, general and administrative expenses for the nine months ended December 31, 2003 were at approximately the same levels as the same period last year.

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

Fab 3 Impairment Charge

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "*Accounting for the Impairment or Disposal of Long-Lived Assets*," which is applicable to financial statements for fiscal years beginning after December 15, 2001. SFAS 144 provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that must be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction because assets held-for-sale are not depreciated and are stated at the lower of book value or fair value less cost to sell. SFAS 144 is effective for all of our financial statements issued subsequent to April 1, 2002. In

accordance with SFAS 144, we recorded a \$41.5 million asset impairment charge during the quarter ended September 30, 2002, as described below.

We acquired Fab 3, a semiconductor manufacturing facility in Puyallup, Washington, in July 2000. The original purchase consisted of semiconductor manufacturing facilities and real property. It was our intention to bring Fab 3 to productive readiness and commence volume production of 8-inch wafers using our 0.7 and 0.5 micron process technologies by August 2001. We delayed our production start up at Fab 3 due to deteriorating business conditions in the semiconductor industry during fiscal 2002. Fab 3 has never been brought to productive readiness.

On August 23, 2002, we acquired Fab 4, a semiconductor manufacturing facility in Gresham, Oregon. We decided to purchase Fab 4 instead of bringing Fab 3 to productive readiness because, among other things, the cost of the manufacturing equipment needed to ramp production at Fab 3 over the next several years was significantly higher than the total purchase price of Fab 4, and the time to bring Fab 4 to productive readiness was significantly less than the time required to bring Fab 3 to productive readiness.

After the acquisition of Fab 4 was completed, we undertook an analysis of the potential production capacity at Fab 4. The results of the production capacity analysis led us to determine that Fab 3's capacity would not be needed in the foreseeable future and during the September 2002 quarter we committed to a plan to sell Fab 3. We have retained a third-party broker to market Fab 3 on our behalf. Accordingly, Fab 3 was classified as an asset held-for-sale as of September 30, 2002 and maintained that classification at December 31, 2003.

We retained an independent third-party firm, other than our independent auditors, to complete a fair value appraisal of Fab 3. The independent third party used the market approach and considered sales of comparable properties in determining the fair value of Fab 3. The comparable sales included eight properties, including our purchases of Fab 3 in July 2000 and Fab 4 in August 2002. We considered the results of this appraisal, in determining the asset impairment charge on Fab 3 of \$36.9 million, including estimated costs to sell. The remaining value of \$60.2 million is classified as an asset held-for-sale and is included as a component of other current assets at December 31, 2003.

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

During the quarter ended December 31, 2002, we also recorded an asset impairment charge of \$4.6 million to write-down certain manufacturing equipment that was excess to our projected requirements located at Fab 3 to its net realizable value of \$212,000. This manufacturing equipment became excess as a result of duplicate equipment acquired in the purchase of Fab 4. The net realizable value for the excess manufacturing equipment was determined based on management estimates. Substantially all of the other manufacturing equipment located at Fab 3 has been transferred to and will be used in our other wafer fabrication facilities located in Tempe, Arizona (Fab 2) and Gresham, Oregon (Fab 4).

Purchased In-Process Research and Development Charge

During the quarter ended June 30, 2002, purchased in-process research and development of \$9.3 million, associated with our acquisition of PowerSmart, Inc., was written off at the date of the acquisition (June 5, 2002) in accordance with FASB Interpretation No. 4, "*Applicability of FASB Statement No. 2 Business Combinations Accounted for by the Purchase Method*" (FIN 4). PowerSmart delivers a battery management whole product solution that improves system runtimes with a lower system cost for the user. Included in the whole product solution is an application tools suite designed to speed up implementation during the user's development and production. The acquisition was intended to strengthen our position in battery management applications such as laptop computers, personal digital assistants, cellular telephones, digital cameras and camcorders.

The assets acquired included in-process research and development for which there is no alternative future uses. Management determined the value assigned to this asset through various methods including assistance from third party appraisal firms in valuing the PowerSmart business. As of the valuation date, there were 15 projects that

were considered to be in process. The values of the projects were determined based on analyses of estimated cash flows to be generated by the products that are expected to result from the in-process projects. These cash flows were estimated by forecasting total revenues expected from these products then deducting appropriate operating expenses, cash flow adjustments and contributory asset returns to establish a forecast of the net return on the in-process technology. These net returns were substantially reduced to take into account the time value of money and the risks associated with the inherent difficulties and uncertainties in achieving commercial readiness. The above analysis resulted in \$9.3 million of value assigned to acquired in-process research and development, which was expensed on the acquisition date in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 Business Combinations Accounted for by the Purchase Method." We believe the assumptions used in valuing in-process research and development are reasonable, but are inherently uncertain. Since the date of the purchase, we incurred development costs of approximately \$3.5 million related to the acquired in-process research and development, and should the projects continue to move toward commercialization, we estimate that future expenditures could approximate \$1.1 million over the next two fiscal years. As of December 31, 2003, three of the in-process research and development projects had been completed, four had been postponed and eight projects continue to be in-process. We expect the eight in-process projects to be completed in fiscal 2005 or before.

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

Other Income (Expense)

Interest income increased in the three-month period ended December 31, 2003 from the corresponding period of the previous fiscal year due to significantly higher invested cash balances, although lower interest rates were earned on these balances. Interest income decreased in the nine-month period ended December 31, 2003 from the corresponding period of the previous fiscal year due to significantly lower interest rates earned on our higher invested cash balances during the nine months ended December 31, 2003, compared to the rates applying to these balances during the corresponding period of the previous fiscal year.

Provision for Income Taxes

Provisions for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings. We had an effective tax rate of 21.4% for the nine months ended December 31, 2003, impacted by \$32.6 million of special charges related to the closure of Fab 1 and other restructuring charges which were tax effected at our applicable U.S. federal and state tax rate of 40%. We had an effective tax rate of 20.7% for the nine months ended December 31, 2002, impacted by a \$9.3 million in-process research and development charge associated with our acquisition of PowerSmart that provided us with no income tax benefit and a \$41.5 million impairment charge on Fab 3 which was tax effected at our applicable U.S. federal and state tax rate of 40%. See Note 10 to our Condensed Consolidated Financial Statements for additional information on our effective tax rates.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax asset will be recovered from future taxable income within the relevant jurisdiction and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. We have not provided for a valuation allowance because we believe that our deferred tax asset will be recovered from future taxable income. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. At December 31, 2003, our gross deferred tax asset was \$122.0 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 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 will be 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.

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

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

Liquidity and Capital Resources

We had \$450.4 million in cash, cash equivalents and short-term investments at December 31, 2003, an increase of \$233.9 million from the March 31, 2003 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 \$15.0 million (U.S. Dollar equivalent). There were no borrowings under the foreign line of credit as of December 31, 2003, but an allocation of approximately \$0.7 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 nine months ended December 31, 2003, we generated \$248.0 million of cash from operating activities, compared to \$203.5 million generated in the nine months ended December 31, 2002. The increase in cash flow from operations was primarily due to changes in profitability, deferred income taxes, accounts receivable and inventory balances.

During the nine months ended December 31, 2003, net cash used in investing activities decreased \$72.3 million, to \$268.9 million, from \$341.2 million for the nine months ended December 31, 2002. The decrease was due to changes in our net purchases, sales and maturities of short-term investments, \$184.5 million for the acquisition of Fab 4 in August 2002, \$50.7 million for the acquisition of PowerSmart in June 2002 and lower capital expenditures in the nine months ended December 31, 2003.

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

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the nine months ended December 31, 2003 were \$39.6 million, compared to \$247.6 million for the nine months ended December 31, 2002. The primary reasons for the dollar decrease in capital expenditures in the nine months ended December 31, 2003 were reductions in our needs for additional

manufacturing capacity due to our purchase of Fab 4 in fiscal 2003. Capital expenditures are primarily for the expansion of production capacity and the addition of research and development equipment. We currently intend to spend approximately \$60 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.

The foregoing statements regarding the anticipated level of capital expenditures over the next 12 months, the nature of such expenditures, the financing and sufficiency of our capital expenditures and the belief that capital expenditures anticipated to be incurred over the next 12 months will provide us sufficient manufacturing capacity to meet our currently anticipated needs are forward-looking statements. Actual results could differ materially because of the following factors, among others: changes in demand for our products and those of our customers; changes in utilization of current manufacturing capacity; unanticipated costs or delays in bringing Fab 4 to production; 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.

Net cash provided by financing activities was \$25.1 million for the nine months ended December 31, 2003. Net cash provided by financing activities was \$12.4 million for the nine months ended December 31, 2002. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plan were \$43.7 million for the nine months ended December 31, 2003 and \$23.9 million for the nine months ended December 31, 2002. Cash expended for the repurchase of our common stock was \$2.5 million in the nine months ended December 31, 2003 and \$7.5 million in the nine months ended December 31, 2002. We paid cash dividends to our shareholders in the nine months ended December 31, 2003 of \$16.0 million and \$4.1 million in the nine months ended December 31, 2002.

On August 7, 2002, our Board of Directors authorized the repurchase of up to 2,500,000 shares of our common stock in the open market or in privately negotiated transactions. As of December 31, 2003, we had repurchased 1,392,200 shares of common stock for \$29,576,077. We repurchased 127,500 shares of common stock for \$2,513,295 during the nine months ended December 31, 2003. As of December 31, 2003, all of the purchased shares had been reissued through stock option exercises and purchases under our employee stock purchase plan. The timing and amount of any future repurchases will depend upon market conditions and corporate considerations.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. A quarterly dividend of \$0.03 per share was paid on December 1, 2003 in the amount of \$6,223,067. A quarterly dividend payment of \$0.035 per share was declared on January 22, 2004 and will be paid on March 5, 2004 to shareholders of record as of February 12, 2004. We expect the March 2004 payment of our quarterly cash dividend to be approximately \$7.3 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 during the next 12 months for the capital expenditures required to maintain or expand our wafer fabrication and product assembly and test facilities, or other purposes. The timing and amount of any such financing requirements will depend on a number of factors, including demand for our products, changes in industry conditions, product mix, and competitive factors. There can be no assurance that such financing will be available on acceptable terms, and any additional equity financing would result in incremental ownership dilution to our existing stockholders.

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

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which addresses consolidation of variable interest entities. FIN 46 expanded the criteria for consideration in determining whether a variable interest entity should be consolidated by a business entity, and requires existing unconsolidated variable interest entities (which include, but are not limited to, Special Purpose Entities, or SPEs) to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. This interpretation applied immediately to variable interest entities created after January 31, 2003. The adoption of this portion of FIN 46 has not had any effect on the Company's financial position or results of operations. This interpretation applies in the first fiscal year or interim period beginning after December 15, 2003, to variable interest entities in which an enterprise holds a variable interest that is acquired before February 1, 2003. We do not have any investments or arrangements which would be considered variable interest, and believe that the adoption of FIN 46 will not have a material impact on our financial position or results of operations.

In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. SFAS 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS 149 did not have a material effect on our financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This Statement requires that certain instruments that were previously classified as equity on a company's statement of financial position now be classified as liabilities. The Statement is effective for financial instruments entered into or modified after May 31, 2003, and to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003. We currently have no instruments impacted by the adoption of this statement and therefore the adoption did not have an effect on our consolidated financial position, results of operations or cash flows.

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
- unanticipated costs or delays in bringing Fab 4 to volume production
- our ability to ramp products into volume production at Fab 4
- the mix of inventory we hold and our ability to satisfy short-term 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 litigation 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 do not ramp our production activities at our Fab 4 (Gresham, Oregon) wafer fabrication facility in a 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
- unanticipated costs.

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

As a result of these and other factors, Fab 4 may not 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 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 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 fiscal 2003 and 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. Because turns orders are difficult to predict, high 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 market.

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. In addition, the raw materials and equipment necessary for our business could become more difficult to obtain as worldwide use of semiconductors in product applications increases. We have experienced supply shortages from time to time in the past, and on occasion our suppliers have told us they need more time than expected to fill our orders or that they will no longer support certain equipment with updates or spare and replacements parts. An interruption of any raw materials or equipment sources, or the lack of supplier support for a particular piece of equipment, could harm our business.

Our business is highly dependent on selling through distributors.

Sales through distributors accounted for 60% of our net sales for the fiscal year ended March 31, 2003 and 63% of our net sales for the nine months ended December 31, 2003. Our largest two distributors together

accounted for approximately 21% of our net sales for the fiscal year ended March 31, 2003, and approximately 24% for the nine months ended December 31, 2003. We do not have long-term agreements with our distributors and our distributors may terminate their relationship with us with little or no advanced notice.

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

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

The semiconductor industry is characterized by wide fluctuations of supply and demand. In recent years, the industry experienced a significant economic downturn, 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 are currently, and in the future may be, involved in legal proceedings or claims regarding patent infringement, intellectual property rights, contracts and other matters. In particular, as discussed in Part II, Item I of this Form 10-Q, we are presently involved in patent infringement litigation with Philips Corporation. In addition, 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 the fiscal year ended March 31, 2003, approximately 71% of our net sales were made to foreign customers. During the nine months ended December 31, 2003, approximately 71% of our net sales were made to foreign customers. We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own 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. 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 rules proposed by the SEC, Nasdaq and the NYSE, could result in increased costs to us as we respond to their requirements. The new rules could make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar

coverage. 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.

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, was valued at \$442.5 million as of December 31, 2003, and \$208.7 million as of March 31, 2003. These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. If market rates were to increase immediately and uniformly by 10% from the levels of December 31, 2003 and March 31, 2003, the decline in the fair value of our investment portfolio would not be material given that the our investments typically have interest rate reset features that regularly adjust to current market rates. Additionally, 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.

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. Substantially all 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 these hedges were immaterial as of March 31, 2003 and there were no hedges outstanding as of December 31, 2003. If foreign currency rates fluctuate by 15% from the rates at December 31, 2003 and March 31, 2003, the effect on our financial position and results of operation would not be material given that we enter into foreign-currency forward contracts to hedge our exposure to foreign currency rate fluctuations.

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.

We believe that our market risk, as discussed in this Item 3 in our Form 10-K, has not materially changed from March 31, 2003.

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 December 31, 2003, 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 December 31, 2003, 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

Microchip Technology Incorporated v. U.S. Philips Corporation, et al. (District of Arizona, 01-CV-2090-PGR); U.S. Philips Corporation v. Atmel Corporation, et al. (Southern District of New York, 01-CV-9178-LAP). As previously reported, on October 26, 2001, we filed an action in federal district court in Arizona for declaratory relief against U.S. Philips Corporation and Philips Electronics North America Corp. requesting that the Court declare, among other matters, that we do not infringe Philips' U.S. Patent Nos. 4,689,740 and 5,559,502. We initiated legal action so that a determination could be made relating to the validity, enforceability and alleged infringement of, and our license to, the Philips' patents. In response to our filing the declaratory judgment action in Arizona, Philips filed an action against us in federal district court in New York, alleging infringement of the '740 patent and seeking unspecified damages and injunctive relief. The Arizona court has agreed to retain jurisdiction, and the New York case has been transferred to Arizona. In response to this development, on December 16, 2002, Philips filed a demand for arbitration in Amsterdam with the International Chamber of Commerce (ICC). We submitted to the ICC Court of Arbitration a jurisdictional objection to proceeding with arbitration pending the outcome of the Arizona litigation. On May 16, 2003, the ICC declined to address whether arbitration is inappropriate for jurisdictional reasons and instead left the issue as one which can be brought before the ICC arbitration panel. On June 13, 2003, the Arizona court granted Microchip's motion to stay the ICC arbitration and proceed with the action in Arizona. Philips has filed a motion to appeal the Arizona court order staying the ICC arbitration. At this time the ICC arbitration, the appeal of the Arizona court order staying arbitration, and the Arizona declaratory judgment action are all pending. We intend to continue to litigate this matter vigorously. We currently believe that the outcome of this matter will not have a material adverse effect on our consolidated financial position or results of operations. However, the final outcome of this matter is inherently uncertain, and should the outcome be adverse to us, we may be required to pay damages and other expenses and may be subjected to injunctive relief. The litigation, even if resolved in our favor, may also result in diversion of management attention and significant legal fees.

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 6. Exhibits and Reports On Form 8-K.

(a) Exhibits.

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

(b) Reports on Form 8-K.

The Company filed a Current Report on Form 8-K on October 16, 2003 to furnish its earnings release for the quarter ended September 30, 2003.

SIGNATURES

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

MICROCHIP TECHNOLOGY INCORPORATED

Date: February 9, 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 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 we 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 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: February 9, 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 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 we 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 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: February 9, 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 December 31, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Microchip Technology Incorporated.

By: /s/ Steve Sanghi
Name: Steve Sanghi
Title: President and Chief Executive Officer
Date: February 9, 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 December 31, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Microchip Technology Incorporated.

By: /s/ Gordon W. Parnell
Name: Gordon W. Parnell
Title: Vice President and Chief Financial Officer
Date: February 9, 2004