INFINEON TECHNOLOGIES AG
Form 20-F
November 26, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15()
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15()
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____ .

Commission file number: 1-15000

Infineon Technologies AG

(Exact name of Registrant as specified in its charter)

Federal Republic of Germany
(Jurisdiction of incorporation or organization)

St.-Martin-Strasse 53,
D-81669 Munich
Federal Republic of Germany
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, notional value €2.00 per share	New York Stock Exchange
Ordinary shares, notional value €2.00 per share *	New York Stock Exchange

- Listed, not for trading or quotation purposes, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

The number of outstanding shares of each of the issuer s classes of capital or common stock as of September 30, 2004: 747,559,859 ordinary shares, notional value €2.00 per share.

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

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 **Item 18**

INFINEON TECHNOLOGIES AG

ANNUAL REPORT ON FORM 20-F
FOR THE FINANCIAL YEAR ENDED
SEPTEMBER 30, 2004

CROSS REFERENCES TO FORM 20-F

PART III:

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). Our consolidated financial statements are expressed in euro. In this annual report, references to euro or € are to euro and references U.S. dollars or $ are to United States dollars. For convenience, this annual report contains translations of euro amounts into U.S. dollars at the rate of €1.00 = $1.2417, the noon buying rate of the Federal Reserve Bank of New York for euro on September 30, 2004. The noon buying rate for euro on November 23, 2004 was €1.00 = $1.3090. Our financial year ends on September 30 of each year. References to any financial year or to FY refer to the year ended September 30 of the calendar year specified. In this annual report, references to:

- our company are to Infineon Technologies AG; and
- we , us or Infineon are to Infineon Technologies AG and, unless the context otherwise requires, to its subsidiaries and its predece the former semiconductor group of Siemens AG.

This annual report contains market data that have been prepared or reported by Gartner Inc. and its unit Dataquest, Inc. (together Gartner Dataquest), IC Insights, Inc. (IC Insights), IMS Research Ltd. (IMS Research), iSuppli Corporation (iSuppli), Strategy Analytics, Inc. Analytics), and World Semiconductor Trade Statistics (WSTS).

Forward-Looking Statements

This annual report contains forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, and you should not place too much reliance on them. Forward looking statements speak only as of the date they are made, and we undertake no obligation to update any of them in light of new information or future events. Forward looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement. These factors include those identified under the heading Risk Factors and elsewhere in this annual report.

Use of Non-GAAP Financial Measures

This document contains non-U.S. GAAP financial measures. Non-U.S. GAAP financial measures are measures of our historical or future performance, financial position or cash flows that contain adjustments that exclude or include amounts that are included or excluded, as the case may be, from the most directly comparable measure calculated and presented in accordance with U.S. GAAP in our financial statements. Earnings before interest and taxes, or EBIT, is an example of a non-U.S. GAAP financial measure. For descriptions of these non-U.S. GAAP financial measures and the adjustments made to the most directly comparable U.S. GAAP financial measures to obtain them, please refer to Operating and Financial Review .

Registered Address

Our registered address is St.-Martin-Strasse 53, 81669 Munich, Germany.

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SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with our consolidated financial statements, the related notes and Operating and Financial Review , all of which appear elsewhere in this annual report.

We have derived the selected consolidated statement of operations and cash flow data for the 2000 through 2004 financial years and the selected consolidated balance sheet data at September 30, 2000 through 2004 from our consolidated financial statements, which have been prepared in accordance with U.S. GAAP and audited by KPMG Deutsche Treuhand Gesellschaft AG, independent registered public accounting firm.

	For the year ended September 30,[1]					
	2000	2001	2002	2003	2004	2004(2)(3)
	(in millions; except per share data)					
Selected Consolidated Statement of Operations data						
Net sales	€ 6,989	€ 5,347	€ 4,890	€ 6,152	€ 7,195	$ 8,934
Cost of goods sold	3,815	4,580	4,289	4,614	4,670	5,799
Gross profit	3,174	767	601	1,538	2,525	3,135
Research and development expenses	1,025	1,189	1,060	1,089	1,219	1,513
Selling, general and administrative expenses	668	782	643	679	718	892
Restructuring charges[4]		117	16	29	17	21
Other operating (income) expense, net	(2)	(200)	(46)	85	257	319
Operating income (loss)	1,483	(1,121)	(1,072)	(344)	314	390
Interest income (expense), net	75	(1)	(25)	(52)	(41)	(51)
Equity in earnings (losses) of associated companies	92	21	(47)	18	(14)	(17)
Gain (loss) on associated company share issuance[5]	53	11	18	(2)	2	2
Other non-operating income (expense), net	36	65	(41)	21	(64)	(79)
Minority interests	(6)	6	7	8	18	22
Income (loss) before income taxes	1,733	(1,019)	(1,160)	(351)	215	267
Income tax (expense) benefit	(614)	427	143	(84)	(154)	(191)
Net income (loss) from continuing operations	1,119	(592)	(1,017)	(435)	61	76
Net income (loss) from discontinued operation	7	1	(4)			
Net income (loss)	€ 1,126	€ (591)	€ (1,021)	€ (435)	€ 61	$ 76
Basic and diluted earnings (loss) per share:						
Continuing operations	€ 1.82	€ (0.92)	€ (1.46)	€ (0.60)	€ 0.08	$ 0.10
Discontinued operations	0.01		(0.01)			
Net income (loss)	€ 1.83	€ (0.92)	€ (1.47)	€ (0.60)	€ 0.08	$ 0.10
Weighted average shares outstanding basic (millions)	614	641	695	721	735	735
	615	641	695	721	737	737

Weighted average shares outstanding diluted (millions)										
Dividends declared per share and per ADS	€ 0.65									
Selected Consolidated Balance Sheet data										
Cash and cash equivalents	€ 511	€ 757	€ 1,199	€ 969	€ 608	$ 755
Marketable securities	498	93	738	1,784	1,938	2,406
Working capital (deficit), excluding cash and cash equivalents and marketable securities	372	(177)	(129)	419	(124)	(154)
Total assets	8,853	9,743	10,918	10,875	10,864	13,490
Short-term debt, including current portion of long-term debt	138	119	120	149	571	709
Long-term debt, excluding current portion	128	249	1,710	2,343	1,427	1,772
Shareholders equity	5,806	6,900	6,158	5,666	5,978	7,423
Selected Consolidated Cash Flow data						
Net cash used in operating activities	2,077	221	226	731	1,857	2,306
Net cash used in investing activities	(2,327)	(1,813)	(1,244)	(1,522)	(1,809)	(2,246)
Depreciation and amortization expenses	€ 834	€ 1,121	€ 1,370	€ 1,437	€ 1,320	$ 1,639

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Notes

(1) Columns may not add due to rounding.

(2) Unaudited.

(3) Converted from euro into U.S. Dollars at an exchange rate of €1 =$1.2417, which was the noon buying rate on September 30, 2004.

(4) These charges relate to the implementation of our Impact cost-reduction programs and other initiatives taken to restructure our organization.

(5) In both 2000 and 2001, ProMOS Technologies, Inc. (ProMOS) shareholders approved the distribution of employee bonuses in the form of shares. In 2002, ProMOS issued Global Depository Receipts in a public share offering and in 2003 ProMOS initiated a share repurchase program. In 2004, Inotera Memories, Inc. (Inotera) distributed employee bonuses in the form of shares. As a result of these share issuances (repurchases), our interest was diluted (increased), while our proportional share of the shareholders equity of these companies increased (decreased).

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OPERATING AND FINANCIAL REVIEW

This discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and other financial information included elsewhere in this annual report. Our audited consolidated financial statements have been prepared on the basis of a number of assumptions more fully explained in Note 1 (Description of Business, Formation and Basis of Presentation) and Note 2 (Summary of Significant Accounting Policies) to our audited consolidated financial statements appearing elsewhere in this annual report.

Overview of the 2004 Financial Year

In our 2004 financial year, which ended September 30, the global economy was generally stronger than in the prior year and the semiconductor market experienced a period of growth. We achieved double-digit revenue growth during the 2004 financial year, primarily as a result of the improvement in demand for our products, especially for DRAM. We improved our gross margin as a result of reductions in per-unit production costs, achieved by converting additional production to our 110-nanometer and 300-millimeter DRAM technology, and by increased capacity utilization. We achieved profitability despite incurring significant charges in connection with antitrust investigations and related claims as well as impairments.

The following were the key developments in our business during the 2004 financial year:

- Our revenues increased by 17 percent, and our earnings before interest and taxes (EBIT) increased from a loss of €299 million in our 2003 financial year to positive EBIT of €256 million in the 2004 financial year.
- We advanced from the seventh-largest semiconductor company worldwide as of June 2003 to the fifth largest as of June 2004, with a market share of 4 percent. The ranking is based on revenues and was made by IC Insights, a leading industry market research firm.
- Our cash flow from operations improved substantially from €731 million in the 2003 financial year to €1,857 million in the 2004 financial year. The improvement was due mainly to improved gross margin and active cash management.
- We continued to invest heavily in research and development and achieved a number of significant milestones during the year, including:
  - Introduction of next-generation GOLDMOS® technology and high-power RF transistors optimized for applications requiring high linear efficiency;
  - Demonstration of the world s first 16-Mbit Magneto-resistive RAM (MRAM) prototype, together with IBM;
  - Introduction of the new CoolSet Power Semiconductor Family, providing the industry s lowest stand-by power consumption; and
  - Demonstration of carbon nanotube transistors for power applications.
- In April 2004, we acquired the Taiwanese chip designer ADMtek Inc., Hsinchu, Taiwan (ADMtek). ADMtek will offer a complete IC solution package, to complete our portfolio of broadband access products for the central office with feature-rich, multimedia gateway solutions for customer premise equipment.
- We agreed to sell our fiber optics business unit (part of our Wireline Communications segment) to Finisar Corporation. We will transfer to Finisar our fiber optics development, manufacturing and related marketing activities, as well as approximately 1,200 employees. Following closing of the transaction, we anticipate holding a 33 percent equity interest in Finisar, which will be one of the largest optical components companies in the market.
- As part of our ongoing project to improve our production processes and expand our production capabilities, we:
  - Successfully transferred to different production facilities our high-performance process technology using structure sizes of 130-nanometer for logic products, in order to further increase our production flexibility;

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- Successfully ramped the 110-nanometer process technology for DRAM products in our 200-millimeter and 300-millimeter production facilities;
- Enlarged our memory chip assembly and testing facility in Porto, Portugal;
- Expanded the scope of our foundry agreement with Winbond, including providing our 90-nanometer DRAM trench technology and 300-millimeter production know-how to Winbond in exchange for increased foundry capacity;
- Recommenced construction of the 300-millimeter facility at our plant in Richmond, Virginia;
- Completed construction of a back-end manufacturing facility in China, which is expected to start mass production in the first half of the 2005 financial year; and
- Saw our joint venture Inotera Memories Inc., Taoyuan, Taiwan (Inotera) complete construction of its 300-millimeter manufacturing facility and start mass production.

- In September 2004, we agreed to settle the ongoing antitrust investigation by the U.S. Department of Justice and related claims by certain of our largest OEM customers. Similar investigations are ongoing in Europe and Canada. We accrued charges of €209 million during the 2004 financial year related to these settlements and investigations.
- We recognized impairment charges of €136 million in the 2004 financial year, principally related to our 2001 acquisition of Catamaran Communications, Inc. (Catamaran) and our decision to terminate our venture investing activities.
- In September 2004, we welcomed Dr. Wolfgang Ziebart as our new CEO.

Our Business

We design, develop, manufacture and market a broad range of semiconductors and complete systems solutions used in a wide variety of microelectronic applications, including computer systems, telecommunications systems, consumer goods, automotive products, industrial automation and control systems, and chip card applications. Our products include standard commodity components, full-custom devices, semi-custom devices, and application-specific components for memory, analog, digital, and mixed-signal applications. We have operations, investments, and customers located mainly in Europe, Asia and North America.

Our business is organized into four principal operating segments serving various markets in the semiconductor industry:

- Our Wireline Communications segment designs, develops, manufactures, and markets semiconductors and fiber optic components for the communications access, WAN (Wide Area Network), MAN (Metropolitan Area Network) and Carrier Access (both broadband and traditional access) sectors of the wireline communications market. We have entered into an agreement for the sale of this segment s fiber optics business to Finisar Corporation.
- Our Secure Mobile Solutions segment designs, develops, manufactures, and markets a wide range of ICs for wireless applications, security controllers, security memories and other semiconductors and complete system solutions for wireless and security applications.
- Our Automotive & Industrial segment designs, develops, manufactures and markets semiconductors and complete systems solutions for use in automotive and industrial applications.
- Our Memory Products segment designs, develops, manufactures, and markets semiconductor memory products with various packaging and configuration options and performance characteristics for standard, specialty and embedded memory applications.

We have two additional segments for reporting purposes, our Other Operating Segments, which includes remaining activities for certain product lines that we have disposed of, as well as other business activities, and our Corporate and Reconciliation segment, which contains items not allocated to our operating segments, such as certain corporate headquarters costs, strategic investments, unabsorbed excess capacity, restructuring costs and corporate IT development expenses.

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The Semiconductor Industry and Factors that Impact our Business

Our business and the semiconductor industry are highly cyclical and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life-cycles and wide fluctuations in product supply and demand. Although these factors affect all segments of our business, they are especially pronounced in our Memory Products segment and have the least impact on our Automotive & Industrial segment.

Cyclicality

The industry s cyclicality results from a complex set of factors, including, in particular, fluctuations in demand for the end products that use semiconductors and fluctuations in the manufacturing capacity available to produce semiconductors. This cyclicality is especially pronounced in the DRAM portion of the industry. Semiconductor manufacturing facilities (so-called fabrication facilities, or fabs) can take several years to plan, construct, and begin operations. Semiconductor manufacturers have in the past made capital investments in plant and equipment during periods of favorable market conditions, in response to anticipated demand growth for semiconductors. If these newly built fabs come on-line at about the same time, the supply of chips to the market is vastly increased. Without sustained growth in demand, this cycle has typically led to manufacturing over-capacity and oversupply of products, which in turn has led to sharp drops in semiconductor prices. When prices drop, manufacturers have in the past cut back on investing in new fabs. As demand for chips grows over time, without additional fabs coming on line, prices tend to rise, leading to a new cycle of investment. The semiconductor industry has generally been slow to react to declines in demand, due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of planned expansion.

We attempt to mitigate the impact of cyclicality by investing in our manufacturing capacities throughout the cycle and entering into alliances and foundry manufacturing arrangements that provide flexibility in responding to changes in the cycle. We believe that we can improve our gross margin by focusing our investment in two key areas: the development of a broader range of products and further improving the flexibility of our manufacturing processes and facilities. These improvements are intended to give us greater flexibility to shift our production, as product demand changes, to higher-margin products, and to ensure optimal utilization of our production facilities.

Substantial Capital and R&D Expenditures

Semiconductor manufacturing is very capital-intensive. The manufacturing capacities that are essential to maintaining a competitive cost position require large investments in manufacturing assets. The top 10 capital spenders in the industry, of which we rank number 8 according to IC Insights, account for more than 50 percent of the industry s average capital expenditure. Manufacturing processes and product designs are based on leading-edge technologies that require considerable research and development expenditures. A high percentage of the cost of operating a fab is fixed; therefore, increases or decreases in capacity utilization can have a significant effect on profitability.

Because pricing, for DRAM products in particular, is market-driven and largely beyond our control, a key factor for us in achieving and maintaining profitability is to continually lower our per-unit costs by reducing our total costs and by increasing unit production output.

To reduce our total costs, we aim to share the costs of research and development and manufacturing facilities with third parties, either by establishing alliances or through the use of foundry facilities for manufacturing. We believe that cooperation in alliances for R&D and manufacturing and foundry partnerships provide us with a number of important benefits, including the sharing of risks and costs, reducing our own capital requirements, allowing us to develop a broader range of products, acquiring technical know-how, and gaining access to additional production capacities. We are developing future DRAM technologies with feature sizes of 90-nanometer and 70-nanometer together with Nanya. In addition, we have set up foundry relationships with partners in Asia, including SMIC and Winbond, to increase our manufacturing capacities, and therefore our revenue base, without investing in additional manufacturing assets.

We expect to increase unit production output through improvements in manufacturing, which is achieved by producing chips with smaller structure sizes (more bits per chip) and by producing more

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chips per silicon wafer (by using larger wafers). For DRAM process technology, we have substantially completed the conversion of our production based on 110-nanometer structure sizes. We are manufacturing at full capacity using 300-millimeter wafers at our facility in Dresden, Germany. Early in the 2003 financial year, the Dresden facility reached the cost cross-over point for 300-millimeter production, which means its per-unit production cost is lower than that in our existing 200-millimeter facilities. We plan to extend these capabilities at our 300-millimeter facility in Richmond, Virginia, in the 2005 financial year.

Technological Development and Competition

Sales prices per unit are volatile and generally decline over time due to technological developments and competitive pressure. DRAMs in particular are commodity-type products. Since most specifications are standardized, customers can switch between suppliers on short notice. This leads to strong competition within the market, and causes manufacturers to pass cost savings on to their customers in an effort to gain market share. Logic products are generally not commodities, but rather have a certain degree of application specification. Although generally less volatile than those for commodity memory products, unit sales prices for logic products typically decline over time as technological developments occur.

We aim to offset the effects of declining unit sales prices on total revenues by increasing unit sales volume, and residual effects on gross margin by continually reducing per-unit production costs. The growth in volumes depends in part on productivity improvements in the manufacturing of semiconductor chips. By moving to ever-smaller structure sizes in manufacturing, the number of functional elements has historically doubled approximately every two years. This trend, often called Moore s Law, has led to an average growth rate of bit-volumes of between 40 percent and 45 percent per year and, assuming constant costs per square inch of silicon, to an approximately 30 percent cost reduction per bit per year.

Seasonality

Our business is affected by seasonality, with sales historically strongest in our fourth financial quarter and weaker in our first financial quarter. The seasonality of our sales reflects the seasonal demand fluctuations for the products that incorporate our semiconductors. If anticipated sales or shipments do not occur when expected, expenses and inventory levels in that quarter can be disproportionately high, and our results of operations for that quarter, and potentially for future quarters, may be adversely affected.

Product Development Cycles

For logic products, the cycle for test, evaluation and adoption of our products by customers before the start of volume production can range from several months to more than one year. Due to this lengthy cycle, we may experience significant delays from the time we incur expenses for research and development, marketing efforts, and investments in inventory, to the time we generate corresponding revenue, if any. Development cycles affect memory products to a lesser extent due to the higher degree of standardization for DRAM products.

Acquisition and Divestiture Strategy

A key element of our business strategy involves the acquisition and divestiture of businesses, assets, products, or technologies to reduce the time required to develop new technologies and products and bring them to market, and to optimize our existing product offerings, market coverage, engineering workforce, or technological capabilities. We plan to continue to evaluate strategic opportunities as they arise, including business combination transactions, strategic relationships, capital investments, and the purchase or sale of assets.

Intellectual Property

Due to the high-technology nature of the semiconductor industry, Intellectual Property (IP), meaning intangible assets relating to proprietary technology, is of significant importance. Companies that have their own patented IP often allow third parties to use their IP in exchange for license fees. It can be costly and difficult to defend against infringement by third parties, or to defend the

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company against claims by third parties of infringement of their technology. We do not record assets in our balance sheet for self-developed IP. Only IP licensed from others or acquired through a business acquisition is reflected on our balance sheet, and reduced through amortization over the expected useful life. The value of such acquired IP is often complex and difficult to estimate.

Challenges that Lie Ahead

Going forward, our success will remain highly dependent on our ability to stay at the leading edge of technology development, and to continue to optimize our product portfolio. We must achieve both objectives to ensure that we have the flexibility to react to fluctuations in market demand for different types of semiconductor products. We believe that the ability to offer and flexibly manufacture a broad portfolio of products will be increasingly important to our long-term success in many markets within the semiconductor industry. Establishing and maintaining advantageous technology, development and manufacturing alliances, including the use of third-party foundries, and continuing our efforts to broaden our product portfolio will make it easier for us to respond to changes in market conditions and to improve our financial performance.

Semiconductor Market Conditions in the 2004 Financial Year

The semiconductor market strengthened significantly during the 2003 calendar year, with growth of 18 percent over the prior year, according to WSTS (World Semiconductor Trade Statistics). In September 2004, WSTS predicted continued growth in the 2004 calendar year of 28 percent over the 2003 calendar year. WSTS further predicts that sales in the Asia/Pacific region will increase by 42 percent in the 2004 calendar year, while other regions are predicted to experience somewhat lower growth: Europe, 21 percent; Japan, 18 percent; and North America, 21 percent. Non-memory products (logic chips, analog, discrete and optical components), which accounted for 78 percent of the entire market in the first half of the 2004 calendar year, are predicted to grow by 24 percent compared with the 2003 calendar year. Memory products are predicted to grow by 46 percent compared with the 2003 calendar year.

Gartner Dataquest predicts worldwide growth in the 2004 calendar year of 37 percent for semiconductors in the communications segments (wireless and wireline). Semiconductors for data processing are predicted to grow by 26 percent, for consumer electronics by 22 percent and for automotive electronics by 23 percent.

During our 2004 financial year, we were able to benefit from these improved market conditions in the worldwide semiconductor industry.

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Results of Operations

Results of Operations as a Percentage of Net Sales

The following table presents the various line items in our consolidated statements of operations expressed as percentages of net sales.

	For the year ended September 30,[1]		
	2002	2003	2004
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	(87.7)	(75.0)	(64.9)
Gross profit	12.3	25.0	35.1
Research and development expenses	(21.7)	(17.7)	(16.9)
Selling, general and administrative expenses	(13.1)	(11.0)	(10.0)
Restructuring charges	(0.3)	(0.5)	(0.2)
Other operating income (expense), net	0.9	(1.4)	(3.6)
Operating (loss) income	(21.9)	(5.6)	4.4
Interest expense, net	(0.5)	(0.8)	(0.6)
Equity in (losses) earnings of associated companies	(1.0)	0.3	(0.2)
Gain (loss) on associated company share issuance	0.4	(0.0)	0.0
Other non-operating (expense) income, net	(0.8)	0.3	(0.9)
Minority interests	0.1	0.1	0.3
Income (loss) before income taxes	(23.7)	(5.7)	3.0
Income tax benefit (expense)	2.9	(1.4)	(2.1)
Net (loss) income	(20.9)%	(7.1)%	0.9%

(1) Columns may not add due to rounding

Net Sales

We generate our revenues primarily from the sale of our semiconductor products and systems solutions. In addition, we also generate less than 5 percent of our sales from activities such as foundry services for divested businesses and the licensing of our intellectual property. Our semiconductor products include two main categories of semiconductors:

- Our memory products, such as dynamic random access memory (DRAM), which are used in computers and other electronic devices. We also offer a limited range of non-volatile flash memory products, which are used in consumer applications such as digital still cameras or cellular handsets.

- Our logic products, which include a wide array of chips and components used in electronic applications ranging from wireless communications devices (such as mobile phones and Bluetooth devices), chip cards, modems and other wireline technologies such as DSL, automotive electronics and industrial applications.

We make the vast majority of our product sales through our direct sales force, with approximately 10 percent of our total revenue in any period derived from sales made through distributors.

We derive our license revenue from royalties and license fees earned on technology that we own and license to third parties. This enables us to recover a portion of our research and development expenses, and also often allows us to gain access to manufacturing capacity at foundries

through joint licensing and capacity reservation arrangements. We recognize license income, primarily in the Memory Products segment, resulting from the transfer of technology to our alliance partners, such as Winbond and Nanya, and, in previous years, our joint venture ProMOS.

Our revenues fluctuate in response to a mix of factors, including the following:

- The market prices for our products, particularly our DRAM products;

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- Our overall product mix and sales volumes;
- The stage of our products in their respective life cycles; and
- The effects of competition and competitive pricing strategies.

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Net Sales	4,890	6,152	7,195
Changes year-on-year		26%	17%
of which:			
License income	147	183	76
% of net sales	3%	3%	1%
Effect of foreign exchange over prior year		(317)	(445)
% of net sales		(5)%	(6)%
Impact of acquisitions over prior year	7	126	29
% of net sales	0%	2%	0%

The increases in net sales in the 2003 and 2004 financial years were mainly driven by higher demand for memory products and semiconductors used in mobile phones, as well as the continued strong performance of the Automotive & Industrial segment. License income increased in 2003 and decreased in 2004 mainly as a result of the termination of our license agreement with ProMOS. The decline of major foreign currencies (primarily the U.S. dollar) relative to the Euro during the 2003 and 2004 financial years negatively impacted reported sales. The effect of foreign exchange over the prior year is calculated as the estimated change in current year sales if the average exchange rate for the preceding year is applied as a constant rate in the current year. The increase in revenues from entities we acquired since the beginning of the prior year reflects primarily the inclusion of a full-year consolidation of sales in the year after the initial acquisition.

Net Sales by Segment:

During the year ended September 30, 2004 we moved certain businesses from the Secure Mobile Solutions segment to the Automotive & Industrial segment. Accordingly, the prior year segment results have been reclassified to be consistent with the revised reporting structure and presentation, as well as to facilitate analysis of current and future operating segment information.

	For the year ended September 30,					
	2002		2003		2004	
	(Euro in millions; except percentages)					
Wireline Communications	€ 386	8%	€ 459	7%	€ 434	6%
Secure Mobile Solutions	1,015	21	1,403	23	1,790	25
Automotive & Industrial	1,464	30	1,634	27	1,820	25
Memory Products	1,861	38	2,485	40	2,926	41
Other Operating Segments	117	2	139	2	196	3
Corporate and Reconciliation	47	1	32	1	29	
Total	€ 4,890	100%	€ 6,152	100%	€ 7,195	100%

- *Wireline Communications* In the 2003 financial year and through the first half of the 2004 financial year we experienced increasing demand for digital access products as the need for DSL internet-based communication increased, and markets in developing countries improved. An offsetting trend is the decrease in demand for traditional analog communication products, which was more pronounced in the second half of the 2004 financial year than in prior periods. The sales decline in the 2004 financial year reflects both declining

volumes of analog and fiber optic products and a decline in average selling prices. Continuing low infrastructure investments by global telecommunications carriers negatively affected the markets for fiber optics and optical networking products during the year, although we

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experienced increased demand in the fourth quarter. Following our decision to divest our fiber optics business, sales of fiber optic products deteriorated in the third quarter, however rebounded in the fourth quarter.

- *Secure Mobile Solutions* Sales growth in the 2003 financial year was particularly strong due to higher volumes of baseband and radio frequency (RF) products for mobile phones and the full year consolidation of Ericsson Microelectronics (MIC), which offset price pressure in our security business. Sales growth in the 2004 financial year was more moderate and occurred primarily in the second half of the year, as demand for mobile solutions accelerated and security products strengthened. We experienced ongoing price pressure in the market for chipcard ICs throughout the 2003 financial year. In the 2004 financial year, revenue benefited from a slower rate of price decline.

- *Automotive & Industrial* The segment experienced continued growth over the past two years as volume growth, particularly for automotive power applications, as a result of the increasing semiconductor content in automotive electronics, more than offset ongoing price pressure caused by technological developments and competition. The increase in net sales in both the 2003 and 2004 financial years resulted principally from higher volume sales of automotive power applications and power management & supply products. Sales also benefited from the full-year consolidation of SensoNor, acquired in June 2003, and accelerated growth for industrial applications in the second half of the 2004 financial year.

- *Memory Products* Sales growth in the past two years was mainly volume-driven, as the DRAM industry recovered and demand increased. The volume growth offset the declining average sales prices in the 2003 financial year. Prices in U.S. dollars declined in the first half and increased in the third quarter of the 2004 financial year, but were on average higher in the 2004 financial year than in the 2003 financial year. The increase in net sales in the 2004 financial year was due mainly to higher volumes which more than offset the impact of an unfavorable U.S. dollar/Euro exchange rate and lower license income. Sales volumes also benefited from the ramp-up of our Dresden 300-millimeter facility, from the conversion to 110-nanometer technology and from access to additional capacity made available through our cooperation with Winbond and SMIC, which offset the reduced volume of products we purchased from ProMOS. Overall megabit volume increased during the 2004 financial year as a result of increasing market demand for personal computers and system memory.

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The prices in U.S. dollars of DDR memory ICs were relatively stable during the 2004 financial year, with slight decreases in January, increases in April and decreases during the fourth quarter of the financial year. Contract prices for our principal volume product, 256-Mbit DDR DRAM, were generally stable, with somewhat greater volatility in the spot market. Per-bit prices for lower-density SDRAM products were higher during the year, because much of the worldwide manufacturing capacity had shifted to higher-density and DDR products. In the middle of calendar year 2004, we began shipments of DDR2 DRAM products, with average selling prices above those of mainstream DDR products. We continue to seek to optimize our product mix to take advantage of market price differentials, and intend to increase our focus on producing specialty products and diversifying our product portfolio. Our average per-megabit selling prices, excluding the effects of currency fluctuations, increased approximately 4 percent in the 2004 financial year.

- *Other Operating Segments* Net sales increased in the 2004 financial year, primarily reflecting the addition of revenues from our ASIC & Design solutions (ADS) business.

Net Sales by Region and Customer:

	For the year ended September 30,					
	2002		2003		2004	
	(Euro in millions; except percentages)					
Germany	1,266	26%	1,535	25%	1,675	23%
Other Europe	943	19	1,112	18	1,263	18
North America	1,158	24	1,393	23	1,524	21
Asia/Pacific	1,287	26	1,821	29	2,263	32
Japan	159	3	256	4	364	5
Other	77	2	35	1	106	1
Total	4,890	100%	6,152	100%	7,195	100%

Our sales grew in all major regions, with Asia/Pacific being our largest sales region and having the strongest growth rate. We expect this trend to continue as more customers expand their operations in low-cost manufacturing centers in Asia, and the Chinese market develops.

With the increased demand for digital access products, our customer base in WirelineCommunications has shifted towards fewer, but larger, customers (reflecting the concentration in the telecommunications industry). The number of customers of our Automotive & Industrial segment remained stable, reflecting the nature of the automobile industry. In the 2004 financial year, customers of our Secure Mobile Solutions segment started to shift production increasingly to countries with emerging economies, such as China and Brazil, which have lower production costs. Memory Product customers have become increasingly concentrated, and in the 2004 financial year our top 10 customers represented 65 percent of that segment s sales.

The Siemens group accounted for 14 percent, 14 percent and 13 percent of our net sales in the 2002, 2003 and 2004 financial years, respectively. Sales to the Siemens group comprise both direct sales (which accounted for 12 percent, 13 percent and 13 percent of net sales, respectively, in those financial years) and sales designated for resale to third parties (which accounted for 2 percent, 1 percent and 0 percent of net sales, respectively, in those financial years). Sales to the Siemens group are made primarily by our non-memory product segments. No other single customer accounted for 10 per cent of our net sales in the 2002, 2003 or 2004 financial year.

Cost of Goods Sold and Gross Margin

Our cost of goods sold consists principally of:

- Direct materials, which consist principally of raw wafer costs;
- Labor costs;

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- Overhead, including maintenance of production equipment, indirect materials, utilities and royalties;
- Depreciation and amortization;
- Subcontracted expenses for assembly and test services;
- Production support, including facilities, utilities, quality control, automated systems and management functions; and
- Foundry production costs.

In addition to factors that affect our revenue, our gross margin is impacted by:

- Factory utilization and related idle capacity costs;
- Amortization of purchased intangible assets;
- Product warranty costs;
- Provisions for excess or obsolete inventories; and
- Government grants, which are recognized over the remaining useful life of the related manufacturing assets.

We report as cost of goods sold the cost of inventory purchased from our joint ventures and other associated and related companies such as ALTIS Semiconductor, Inotera and through January1, 2003, ProMOS. Our purchases from these affiliated entities amounted to €357 million in the 2004 financial year, €470 million in the 2003 financial year and €686 million in the 2002 financial year.

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Cost of goods sold	4,289	4,614	4,670
Changes year-on-year		8%	1%
% of net sales	88%	75%	65%
Gross margin	12%	25%	35%

The gross margin improvement over the past two financial years is attributable to a variety of factors, including improved integration and higher capacity utilization in most of our segments, a substantially improved cost position in our memory products segment, and a better overall pricing environment than in the prior financial years.

The gross margin development in our segments was as follows:

- *Wireline Communications* Gross margin improved in the 2003 financial year mainly due to increased volumes of higher-margin access products, productivity gains and higher capacity utilization. Gross margin was on average the same in the 2004 financial year as in the 2003 financial year, although decreasing throughout the year from a high in the first quarter. This was principally due to the continuing price decline experienced mainly for access products.
- *Secure Mobile Solutions* Gross margin improved in the second half of the 2003 financial year into the first quarter of the 2004 financial year and was maintained until the year end. This was mainly as a result of improved demand for wireless and security products and higher capacity utilization which offset the effect of continuing price decline. Gross margin was positively affected in the 2004 financial year by a slower rate of price decline and improved cost position for the previously acquired MIC business, and negatively impacted in the 2003 financial year due to continued pricing pressure throughout the year.
-

Automotive & Industrial Gross margin improved as a result of increased productivity and cost reductions attributable to the conversion from 5-inch to 6-inch and 8-inch wafer manufacturing. Higher sales volumes and increased capacity utilization contributed to improved efficiencies and offset the adverse effect of pricing pressure on gross margin.

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- *Memory Products* Gross margin consistently improved over the past two years mainly due to improved productivity and reduced manufacturing costs related to 140- and 110-nanometer conversion and 300-millimeter production efficiencies. These more than offset the effects of lower average selling prices in the 2003 financial year, and led to a significant increase in gross margin towards the second half of the 2004 financial year. The gross margin impact in the 2004 financial year of lower license income was partially offset by reduced depreciation expense attributable to governmental grants.

Research and Development (R&D) Expenses

Research and development expenses consist primarily of salaries and fringe benefits for research and development personnel, material costs, depreciation and maintenance of equipment used in our research and development efforts, and contracted technology development costs. Material costs include expenses for development wafers and costs relating to pilot production activities prior to the commencement of commercial production. R&D expenses also include our joint technology development arrangements with partners such as Nanya and IBM.

We continue to focus our investments on the development of leading-edge manufacturing technologies with high growth potential, particularly in our Secure Mobile Solutions and Memory Products segments.

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Research and development expenses	1,060	1,089	1,219
Changes year-on-year		3%	12%
% of net sales	22%	18%	17%
In-process R&D charges	37	6	9
% of net sales	1%	0%	0%
Government subsidies	59	59	74
% of net sales	1%	1%	1%

In-process R&D charges relate to specific acquisitions: Ericsson Microelectronics (MIC) in the 2002 financial year, mainly SensoNor in the 2003 financial year and ADMtek in the 2004 financial year. Each charge is unique to the acquisition and depends on a variety of factors such as the stage of technology development and the anticipated future use at the acquisition date.

Some of our R&D projects qualify for subsidies from local and regional governments where we do business. If the criteria to receive a grant are met, the subsidies received reduce R&D expenses over the project term as expenses are incurred.

- *Wireline Communications* R&D expenses decreased in each of the 2003 and 2004 financial years in absolute terms and relative to sales. In the 2003 financial year, this was mainly due to lower amortization expenses relating mainly to our Catamaran Communications acquisition, and reduced spending for access product lines in accordance with our Impact cost-reduction program. In the 2004 financial year costs were reduced, mainly through cutbacks in optical networking, which was partially offset by in-process R&D charges in connection with the ADMtek acquisition.

- *Secure Mobile Solutions* R&D expenses increased in absolute terms as we increased our focus on software and solutions activities and third-generation mobile phone semiconductors. In the 2003 financial year, this effect was reduced by the €37 million in-process R&D charge recognized in the 2002 financial year, which did not reoccur.

- *Automotive & Industrial* R&D expenses increased in absolute terms and remained constant in relation to sales, as a result of increased R&D spending in the fields of microcontrollers and automotive applications. We expensed in-process R&D of €4 million in connection with the SensoNor acquisition in the 2003 financial year.

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- *Memory Products* R&D expenses decreased in both absolute terms and as a percentage of sales in the 2003 financial year, demonstrating the benefits of the joint development of DRAM technologies with Nanya. In the 2004 financial year, this reduction was more than offset by increased development expenditures for commodity DRAM and flash technologies, resulting in an overall increase in absolute terms, although constant relative to sales.

Selling, General and Administrative (SG&A) Expenses

Selling costs consist primarily of salaries and fringe benefits for personnel engaged in sales and marketing activities, costs of customer samples, costs related to prototyping activities, other marketing incentives, and related marketing expenses.

General and administrative expenses consist primarily of salaries and benefits for administrative personnel, non-manufacturing related overhead costs, consultancy, legal and other fees for professional services, recruitment and training expenses.

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Selling, general and administrative expenses	643	679	718
Changes year-on-year		6%	6%
% of net sales	13%	11%	10%

The decline as a percentage of net sales in each year was mainly due to our sales increasing at a faster rate than our expenditures.

Selling expenses increased in absolute terms over the past two years due to increased sales and higher-volume business as well as expansion in the Asia/Pacific region, partially offset by sales and marketing cost-reduction programs in our Wireline Communications and Secure Mobile Solutions segments.

The increase in general and administrative expenses over the past two years was mainly attributable to higher information technology (IT) expenditures, professional fees, and expenses associated with expanding our presence in the USA and Asia and was partially offset by savings from our cost-reduction programs. The full-year consolidation of the acquired MIC business increased the selling, general and administrative expenses of our Secure Mobile Solutions segment in the 2003 financial year. Accruals for legal costs related to litigation and settlements also increased in the 2004 financial year.

Other items affecting earnings

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Restructuring charges	16	29	17
% of net sales	0%	0%	0%
Other operating (income) expense, net	(46)	85	257
% of net sales	(1)%	1%	4%
Equity in (losses) earnings of associated companies	(47)	18	(14)
% of net sales	(1)%	0%	(0)%
Other non-operating (expense) income, net	(41)	21	(64)
% of net sales	(1)%	0%	(1)%

Restructuring Charges. In the 2004 financial year, we continued our restructuring and cost-saving efforts. In connection with our decision to close down various development centers in the 2004

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financial year, we recorded restructuring charges, mainly for severance payments. In the 2003 financial year we accrued charges for severance payments to eliminate excess overhead. In the 2002 financial year, we recorded restructuring expenses principally relating to non-cancelable commitments.

Other Operating Income (Expense), Net. Other net operating expense in the 2004 financial year related principally to charges related to our settlement in an antitrust investigation by the U.S. Department of Justice, related settlements with customers and a similar ongoing investigation in Europe, as well as a goodwill impairment charge of €71 million related to our 2001 acquisition of Catamaran. In the 2003 financial year, we also recorded a goodwill impairment charge of €68 million related to Catamaran and made a provision related to the U.S. antitrust matters noted above. In the 2002 financial year, other net operating income reflected pre-tax gains of €39 million from the sale of the remaining part of our infrared components business, and €2 million from the sale of our gallium arsenide business.

Equity in (Losses) Earnings of Associated Companies. Our principal associated companies are ALTIS, Inotera (since the 2003 financial year) and ProMOS (until the 2003 financial year). Both ProMOS and Inotera are DRAM manufacturers and our equity in their earnings has been sensitive to fluctuations in the price of DRAM and reflected in the results of the Memory Products segment.

Losses in the 2002 financial year were mainly caused by ProMOS as a result of low DRAM prices. In the 2003 financial year, the recovery in DRAM prices resulted in improved earnings at ProMOS prior to our withdrawal from the venture. Start-up losses at Inotera during the ramp-up phase of production contributed to the losses incurred in the 2004 financial year.

Other Non-Operating (Expense) Income, Net. Other income and expense can consist of various items from period to period not directly related to our principal operations, including gains and losses on sales of marketable securities. Other net non-operating expense in the 2004 financial year mainly consisted of €65 million of investment-related impairment charges. In the 2003 financial year, a €60 million gain on the sale of ProMOS shares was partially offset by impairment charges of €34 million related to certain investments, and a €9 million loss on the sale of our interest in UMCi. The 2002 financial year s amount mainly reflected impairment charges related to investments.

Earnings Before Interest and Taxes (EBIT)

We define EBIT as earnings (loss) before interest and taxes. Our management uses EBIT as a measure to establish budgets and operational goals, to manage our business and to evaluate its performance. We report EBIT information because we believe that it provides investors with meaningful information about our operating performance and especially about the performance of our separate business segments. EBIT is determined from the statement of operations as follows:

	For the year ended September 30,		
	2002	**2003**	**2004**
	(Euro in millions)		
Net income (loss) from continuing operations	(1,017)	(435)	61
Add: Income tax (benefit) expense	(143)	84	154
Interest expense, net	25	52	41
EBIT	(1,135)	(299)	256

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The EBIT amounts of our separate business segments were as follows:

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions)		
Wireline Communications	€ (245)	€ (188)	€ (179)
Secure Mobile Solutions	(143)	(65)	124
Automotive & Industrial	138	187	244
Memory Products	(630)	31	169
Other Operating Segments	9	(49)	(58)
Corporate and Reconciliation	(264)	(215)	(44)
Total	€ (1,135)	€ (299)	€ 256

The EBIT improvement reflects the combined effects of the following EBIT movements of our reporting segments:

- *Wireline Communications* the EBIT loss decreased in the 2004 financial year due to lower operating costs, but partially offset by losses associated with the acquisition of ADMtek. EBIT for the 2003 and 2004 financial years includes goodwill impairments of €68 million and €71 million, respectively, related to our Catamaran acquisition. The reduction in the EBIT loss in the 2003 financial year was principally driven by improved sales volumes, improved product mix, and improved margin in our fiber optics business, as well as cost savings from restructuring and other cost-reduction efforts.

- *Secure Mobile Solutions* the return to profitability in the 2004 financial year was principally due to substantially increased sales and a moderately improved pricing environment. The reduction in EBIT loss in the 2003 financial year resulted from substantially increased sales, and improved gross margins, as well as the effects from cost reduction efforts, which offset the full-year consolidated effect of the acquired MIC business.

- *Automotive & Industrial* the EBIT improvements in the 2003 and 2004 financial years were mainly due to higher sales volumes and improved manufacturing efficiency, partially offset by continued pricing pressure.

- *Memory Products* the EBIT improvement in the 2004 financial year was primarily due to increased sales volumes, and productivity improvements, which offset the weak U.S. dollar/ Euro exchange rate, lower license income and antitrust related charges. The return to profitability in the 2003 financial year was attributable to increased sales volumes, substantially reduced manufacturing costs and increased license income.

- *Other Operating Segments* the EBIT losses in the 2003 and 2004 financial years mainly reflect investment-related impairment charges. Expenditures associated with establishing our ASIC & Design solutions (ADS) business in the 2003 financial year were significantly reduced and led to profitability in the 2004 financial year.

- *Corporate and Reconciliation* the EBIT loss decreased in the 2003 financial year and particularly in the 2004 financial year principally reflecting reduced idle-capacity costs resulting from improved utilization.

Interest Expense, Net

We derive interest income primarily from cash and cash equivalents and marketable securities. Interest expense is primarily attributable to bank loans and convertible notes, and excludes interest capitalized on manufacturing facilities under construction.

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	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Interest expense, net	(25)	(52)	(41)
% of net sales	(1)%	(1)%	(1)%

Interest expense since the 2002 financial year relates principally to the convertible bonds that we issued in February 2002 and in June 2003. This effect was partially reduced in the 2004 financial year through the redemption of a portion of our convertible bonds and increased interest capitalization related to facilities under construction.

Income Taxes

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions; except percentages)		
Income tax benefit (expense)	143	(84)	(154)
% of net sales	3%	(1)%	(2)%
Effective tax rate	12%	(24)%	72)%

Pursuant to U.S. GAAP, deferred tax assets in tax jurisdictions that have a three-year cumulative loss are subject to a valuation allowance excluding the impact of forecasted future taxable income. In the 2002 financial year we recorded an increase to the valuation allowance of €271 million, which limited the net tax benefit recognized, because we had incurred a cumulative loss in certain tax jurisdictions over the three-year period ended September 30, 2002. In the 2003 financial year, we again recognized no tax benefits in these jurisdictions and we increased the valuation allowance by €182 million, however, we continued to record tax expense in profitable tax jurisdictions. In the 2004 financial year, our effective tax rate increased because we recorded additional valuation allowances of €54 million related to tax jurisdictions that continue to have a three-year cumulative loss, and also had more non-deductible expenditures. We assess our deferred tax asset position on a regular basis. Our ability to realize benefits from our deferred tax assets is dependent on our ability to generate future taxable income sufficient to utilize tax loss carry-forwards or tax credits before expiration. We expect to continue to recognize no tax benefits in these jurisdictions until we have ceased to be in a cumulative loss position for the preceding three-year period.

Net Income (Loss)

Net loss decreased significantly in the 2003 financial year principally as a result of sales volume growth and manufacturing efficiencies and cost reduction efforts. This trend continued in the 2004 financial year, resulting in the achievement of profitability, although the impact was reduced through the increased charges for impairments, antitrust-related matters and tax expense.

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Financial Condition

	For the year ended September 30,		
	2003	2004	% Change year-on-year
	(Euro in millions, except percentages)		
Current assets	5,376	5,292	(2)%
Non-current assets	5,499	5,572	1%
Total assets	10,875	10,864	(0)%
Current liabilities	2,204	2,870	30%
Non-current liabilities	3,005	2,016	(23)%
Total liabilities	5,209	4,886	(6)%
Shareholders equity	5,666	5,978	6%

As of September 30, 2004, our total assets were at the same level as at the end of the 2003 financial year. Total current assets decreased at the end of the 2004 financial year due to the net effect of a variety of actions, including the use of cash to repay €549 million of long-term debt, offset by increases in accounts receivable and marketable securities. Non-current assets increased slightly at the end of the 2004 financial year as depreciation, amortization and impairment charges mostly offset capital expenditures and investments in associated companies during the year.

Total liabilities decreased as of the end of the 2004 financial year, mainly due to the redemption of a notional amount of €360 million of our convertible notes due 2007 during the 2004 financial year. Current liabilities mainly increased and non-current liabilities further decreased due to prior year long-term debt approaching short-term maturity as of September 30, 2004.

Our shareholders equity increased principally due to the issuance of 26,679,255 ordinary shares relating to the acquisition of the remaining interest in Infineon Technologies SC300 GmbH & Co. OHG (SC300) and 2004 net income. At September 30, 2004, shareholders equity as a percentage of total assets was 55 percent, compared with 52 percent at September 30, 2003.

The equity return and the return of assets both amounted to 1 percent in the 2004 financial year compared to (4) percent and (7) percent, respectively, in the 2003 financial year because of the achievement of profitability in the 2004 financial year. The equity-to-fixed-assets ratio improved in the 2004 financial year to 167 percent because depreciation exceeded capital expenditures during the year. The decrease of the debt-to-equity ratio to 33 percent, compared to 44 percent in the 2003 financial year, was attributable to the redemption of a portion of our convertible notes during the 2004 financial year.

Liquidity

Cash Flow

Our statement of cash flows shows the sources and uses of cash during the reported periods. It is of key importance for the evaluation of our financial position.

Cash flows from investing and financing activities are both indirectly determined based on payments and receipts. Cash flows from operating activities are determined indirectly from net income (loss). The changes in balance sheet items in connection with operating activities have been adjusted for the effects of foreign currency exchange fluctuations and for changes in the scope of consolidation. Therefore, they do not conform to the corresponding changes in the respective balance sheet line items.

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	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions)		
Net cash provided by operating activities continuing operations	226	731	1,857
Net cash used in investing activities	(1,244)	(1,522)	(1,809)
Net cash provided by (used in) financing activities	1,448	566	(402)
Net cash provided by (used in) operating activities discontinued operations	11	(1)	
Cash and cash equivalents at year end	1,199	969	608

Cash provided by operating activities in the 2004 financial year resulted mainly from net income of €61 million, which is net of non-cash charges for depreciation of €1,320 million and impairment charges of €136 million and deferred taxes of €96 million. Cash provided by operating activities was positively impacted by an increase in accrued liabilities of €148 million, related to the antitrust investigations and related civil claims. These effects were partly offset by the increase of trade accounts receivable of €219 million and the increase of inventories of €40 million due to increased business volume.

Cash used in investing activities in the 2004 financial year mainly reflects capital expenditures of €1,163 million, principally to equip our plants in Dresden and Richmond, investments of €386 million in associated companies, such as our Inotera joint venture, and net purchases of marketable securities of €158 million.

Cash used for financing activities in the 2004 financial year principally relates to the redemption of €360 million of our convertible subordinated notes due 2007.

Free Cash Flow

We define free cash flow as cash from operating and investing activities excluding purchases or sales of marketable securities. Since we hold a substantial portion of our available monetary resources in the form of readily available marketable securities, and operate in a capital-intensive industry, we report free cash flow to provide investors with a measure that can be used to evaluate changes in liquidity after taking capital expenditures into account. It is not intended to represent the residual cash flow available for discretionary expenditures, since debt service requirements or other non-discretionary expenditures are not deducted. The free cash flow is determined as follows from the cash flow statement:

	For the year ended September 30,		
	2002	2003	2004
	(Euro in millions)		
Net cash provided by operating activities total	237	730	1,857
Net cash used in investing activities	(1,244)	(1,522)	(1,809)
Purchases of marketable securities, net	647	739	158
Free cash flow	(360)	(53)	206

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Net Cash Position

The following table presents our gross and net cash positions and the maturity of debt. It is not intended to be a forecast of cash available in future periods.

		Payments due by period					
as of September 30, 2004	Total	Less than 1 year	1-2 years	2-3 years	3-4 years	4-5 years	After 5 years
		(Euro in millions)					
Cash and cash equivalents	€ 608	€ 608	€	€	€	€	€
Marketable securities	1,938	1,938					
Gross cash position	2,546	2,546					
Less:							
Long-term debt	1,427		49	655	5	2	716
Short-term debt and current maturities	571	571					
Total financial debt	1,998	571	49	655	5	2	716
Net cash position	548	1,975	(49)	(655)	(5)	(2)	(716)

Our gross cash position representing cash and cash equivalents, plus marketable securities decreased by €207 million to €2,546 million at September 30, 2004, compared with €2,753 million at the prior year end. The decrease was principally due to the repayment of €549 million of long-term debt (mainly convertible notes), which more than offset the free cash flow of €206 million.

Long-term debt principally consists of convertible notes that were issued in order to strengthen our liquidity position and allow us more financial flexibility in conducting our operational business. The total outstanding convertible notes as of September 30, 2004 amounted to €1,340 million.

On June 5, 2003, we issued €700 million in subordinated convertible notes due 2010 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 68.4 million ordinary shares of our company, at a conversion price of Euro 10.23 per share through maturity.

On February 6, 2002, we issued €1,000 million in subordinated convertible notes due 2007 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 28.2 million of our company s ordinary shares at a conversion price of Euro 35.43 per share through maturity. During the 2004 financial year we redeemed €360 million of our convertible notes due 2007.

Our net cash position meaning cash and cash equivalents, plus marketable securities, less total financial debt increased by €287 million to €548 million at September 30, 2004, compared with €261 million at September 30, 2003, principally as a result of free cash flow of €206 million.

To secure our cash position and to keep flexibility with regards to liquidity, we have implemented a policy with risk limits for the amounts deposited with respect to the counterparty, credit rating, sector, duration, credit support and type of instrument.

Capital Requirements

We require capital in our 2005 financial year to:

- Finance our operations;

-
- Make scheduled debt payments;
- Settle contingencies if they occur; and
- Make planned capital expenditures.

We can meet these requirements through:

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- Cash flow generated from operations;
- Cash on hand and securities we can sell; and
- Available credit facilities.

As of September 30, 2004, we require funds for the 2005 financial year aggregating €2,135 million, consisting of €571 million for short-term debt payments and €1,564 million for commitments. In addition, we may need up to €68 million for currently known contingencies. We also plan to invest up to an additional €567 million in capital expenditures and financial and equity investments that have not been otherwise committed. The aggregate capital required for such commitments, contingencies and planned capital expenditures during the 2005 financial year is €2,770 million as of September 30, 2004. We have a gross cash position of €2,546 million as of September 30, 2004, and also the ability to draw funds from available credit facilities of €1,086 million.

As of September 30, 2004, we had debt of €571 million scheduled to become due within one year. The main component is our €450 million syndicated credit facility relating to the expansion of the Dresden manufacturing facility, which was fully drawn as of September 30, 2004, and matures on September 30, 2005.

Commitments and Contingencies

	Payment Due/Expirations by Period						
as of September 30, 2004[1][2]	**Total**	**Less than 1 year**	**1-2 years**	**2-3 years**	**3-4 years**	**4-5 years**	**After 5 years**
				(Euro in millions)			
Contractual commitments:							
Operating lease payments	918	83	101	77	74	55	528
Unconditional purchase commitments	1,711	1,356	187	69	37	17	45
Other long-term commitments	321	125	50	45	101		
Total commitments	2,950	1,564	338	191	212	72	573
Other contingencies:							
Guarantees	419	10		304			105
Contingent government grants[3]	433	58	52	161	126	33	3
Total contingencies	852	68	52	465	126	33	108

The above table should be read together with Note 31 to our consolidated financial statements for the year ended September 30, 2004.

(1) Certain payments of obligations or expiration of commitments that are based on the achievement of milestones or other events that are not date-certain are included for purposes of this table, based on our estimate of the reasonably likely timing of payments or expirations in each particular case. Actual outcomes could differ from those estimates.

(2) Product purchase commitments associated with capacity reservation agreements are not included in this table, since the purchase prices are based, in part, on future market prices, and are accordingly not quantifiable at September 30, 2004. Purchases under these agreements aggregated €683 million for the year ended September 30, 2004.

(3) Contingent government grants refer to amounts previously received, related to the construction and financing of certain production facilities, which are not guaranteed otherwise and could be refundable if the total project requirements are not met.

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Capital Expenditures

	For the year ended September 30,		
	2002	**2003**	**2004**
		(Euro in millions)	
Memory products	464	576	716
Non-memory products	179	296	447
Total	643	872	1,163

We expect to invest between €1 billion and €1.3 billion in capital expenditures in the 2005 financial year, largely for our 300-millimeter manufacturing facility in Richmond, Virginia, as well as improving productivity and upgrading technology at existing facilities. As of September 30, 2004, €833 million of this amount has been committed and included in unconditional purchase commitments. Due to the lead times between ordering and delivery of equipment, a substantial amount of capital expenditures typically is committed well in advance. Approximately 60 percent of these expected capital expenditures will be made in the Memory Products segment s front-end and back-end facilities. In addition, we expect to make financial and equity investments of up to €200 million in the 2005 financial year, of which approximately €100 million has been committed as of September 30, 2004 and included in other long-term commitments.

Credit Facilities

We have established both short- and long-term credit facilities with a number of different financial institutions in order to meet our anticipated funding requirements. These facilities, which aggregate €1,760 million, of which €1,086 million remained available at September 30, 2004, comprise the following:

			As of September 30, 2004		
Term	**Nature of financial institution commitment**	**Purpose/intended use**	**Aggregate facility**	**Drawn**	**Available**
				(Euro in millions)	
short-term	firm commitment	working capital, guarantees, cash management	163	73	90
short-term	no firm commitment	working capital	272		272
long-term	firm commitment	working capital	724		724
long-term[(1)]	firm commitment	project finance	601	601	
Total			1,760	674	1,086

(1) Including current maturities.

In September 2004 we executed a $400/€400 million syndicated credit facility with a five-year term. The facility consists of two tranches: Tranche A is a $400 million term loan intended to finance the expansion of our Richmond, Virginia, manufacturing facility. Tranche B is a €400 million multicurrency revolving facility to be used for general corporate purposes. Tranche B replaces our previous €375 million multicurrency credit facility expiring in 2005. The maximum outstanding amount of Tranche A will decrease on the basis of a repayment schedule that foresees equal instalments starting from September 30, 2006. The facility has customary financial covenants, and drawings bear interest at market-related rates that are linked to financial performance. The lenders of the aforementioned $400/€400 million credit facility have been granted a negative pledge relating to our future financial indebtedness with certain permitted encumbrances. At September 30, 2004, no amounts were outstanding under this facility.

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At September 30, 2004, we were in compliance with our debt covenants under the relevant facilities.

We plan to fund our working capital and capital requirements from cash provided by operations, available funds, bank loans, government subsidies and, if needed, the issuance of additional debt or equity securities. We have also applied for governmental subsidies in connection with certain capital expenditure projects, but can provide no assurance that such subsidies will be granted in a timely fashion or at all. We can provide no assurance that we will be able to obtain additional financing for our research and development, working capital or investment requirements or that any such financing, if available, will be on terms favorable to us.

Taking into consideration the financial resources available to us, including our internally generated funds and currently available banking facilities, we believe that we will be in a position to fund our capital requirements in the 2005 financial year.

Other Matters

Employees

The following table indicates the composition of our workforce by function and region at the end of the financial years indicated.

	As of September 30,		
	2002	**2003**	**2004**
Function:			
Production	20,822	22,405	24,540
Research & development	5,374	5,935	7,160
Sales & marketing	2,010	2,048	1,948
Administrative	2,217	1,920	1,922
Total	30,423	32,308	35,570
Region:			
Germany	15,716	16,166	16,387
Other Europe	4,590	5,034	5,631
North America	2,889	2,757	2,982
Asia/Pacific	7,093	8,116	10,340
Japan	107	118	133
Other	28	117	97
Total	30,423	32,308	35,570

In the 2003 financial year, our headcount increased as a result of the ramp-up of our 300-millimeter production and through the acquisition of SensoNor. In the 2004 financial year, our headcount increased principally due to the expansion of manufacturing capacities in Germany, Malaysia and China.

Campeon

We entered into a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG (MoTo) to lease an office complex being constructed by MoTo south of Munich, Germany. The office complex will enable us to locate our employees, who are currently situated in various locations throughout Munich, in one central physical working environment. MoTo is responsible for the construction, which is expected

to be completed in the second half of 2005. We have no obligations with respect to financing MoTo, and have provided no guarantees related to the construction.

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Critical Accounting Policies

Our results of operations and financial condition are dependent upon accounting methods, assumptions and estimates that we use as a basis for the preparation of our consolidated financial statements. We have identified the following critical accounting policies and related assumptions, estimates and uncertainties, which we believe are essential to understanding the underlying financial reporting risks and the impact that these accounting methods, assumptions, estimates and uncertainties have on our reported financial results.

Revenue Recognition

We generally market our products to a wide variety of end users and a network of distributors. Our policy is to record revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, shipment is made and collectibility is reasonably assured. We record reductions to revenue for estimated product returns and allowances for discounts and price protection, based on actual historical experience, at the time the related revenue is recognized. We establish reserves for sales discounts and price protection allowances based upon our evaluation of a variety of factors, including industry demand and our forecast of future pricing. This process requires the exercise of substantial judgments in evaluating the above-mentioned factors and requires material estimates, including forecasted demand, returns and industry pricing assumptions.

In future periods, we may decide to accrue additional provisions due to (1) deterioration in the semiconductor pricing environment, (2) reductions in anticipated demand for semiconductor products or (3) lack of market acceptance for new products. If these or other factors result in a significant adjustment to sales discount and price protection allowances, they could significantly impact our future operating results.

We have entered into licensing agreements for our technology in the past, and anticipate that we will increase our efforts to monetize the value of our technology in the future. As with certain of our existing licensing agreements, any new licensing arrangements may include capacity reservation agreements with the licensee. Such transactions could represent multiple element arrangements pursuant to SEC Staff Accounting Bulletin 104, Revenue Recognition, and EITF Issue 00-21, Revenue Arrangements with Multiple Elements. The process of determining the appropriate revenue recognition in such transactions is highly complex and requires significant judgments, which includes evaluating material estimates in the determination of fair value and the level of our continuing involvement.

Recoverability of Long-Lived Assets

Our business is extremely capital-intensive, and requires a significant investment in property, plant and equipment. Due to rapid technological change in the semiconductor industry, we anticipate the level of capital expenditures to be significant in future periods. During the 2004 financial year, we spent €1,163 million to purchase property, plant and equipment. At September 30, 2004, the carrying value of our property, plant and equipment was €3,587 million. We have acquired other businesses, which resulted in the generation of significant amounts of long-lived intangible assets, including goodwill. These included ADMtek in the 2004 financial year.

At September 30, 2004 we had long-lived intangible assets of €398 million.

We adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, as of October 1, 2001. The adoption of SFAS No. 142 did not result in any impairment as of the adoption date. Pursuant to the requirements of SFAS No. 142, a test for impairment is done at least once a year.

We review long-lived assets, including intangible assets, for impairment when events or changes in circumstance indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets. Estimated fair value is generally based on either appraised value or discounted estimated future cash flows.

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We tested goodwill for impairment pursuant to SFAS No.142 and recognized impairment charges of €68 million and €71 million during the years ended September 30, 2003 and 2004, respectively, related to our 2001 acquisition of Catamaran.

Valuation of Inventory

Historically, the semiconductor industry has experienced periods of extreme volatility in product demand and in industry capacity, resulting in significant price fluctuations. Since semiconductor demand is concentrated in such highly-volatile industries as wireless communications, wireline communications and the computer industry, this volatility can be extreme. This volatility has also resulted in significant fluctuations in price within relatively short time-frames. For example, the spot market price for 256-Mbit DDR DRAM fluctuated from $4.47 at January 30, 2004 to $5.15 at April 30, 2004.

As a matter of policy, we value inventory at the lower of cost or market. We review the recoverability of inventory based on regular monitoring of the size and composition of inventory positions, current economic events and market conditions, projected future product demand, and the pricing environment. This evaluation is inherently judgmental and requires material estimates, including both forecasted product demand and pricing environment, both of which may be susceptible to significant change. At September 30, 2004, total inventory was €960 million.

In future periods, write-downs of inventory may be necessary due to (1) reduced semiconductor demand in the computer industry and the wireless and wireline communications industries, (2) technological obsolescence due to rapid developments of new products and technological improvements, or (3) changes in economic or other events and conditions that impact the market price for our products. These factors could result in adjustments to the valuation of inventory in future periods, and significantly impact our future operating results.

Recoverability of Long-Term Investments

We have made a series of investments in companies that are principally engaged in the research and development, design, and manufacture of semiconductors and related products. At September 30, 2004, the carrying value of our long-term investments totaled €708 million.

At September 30, 2004, our two most significant long-term investments were our investments in ALTIS Semiconductor, which is a joint venture with IBM, and Inotera, which is a joint venture with Nanya.

Our accounting policy is to record an impairment of the net realizable value of investments when the decline in fair value below carrying value is other-than-temporary. In determining if a decline in value is other-than-temporary, we consider factors such as the length of time and magnitude of the excess of carrying value over market value, the forecasted results of the investee, the economic environment and state of the industry and our ability and intent to hold the investment. We recognized impairment charges of €65 million during the 2004 financial year as a result of such impairment tests, in connection with our decision to terminate our venture investment activities and the disposal of our remaining investment portfolio, as well as other investment write-downs.

The high cyclicality in the semiconductor industry could adversely impact the operations of these investments and their ability to generate future net cash flows. Furthermore, to the extent that these investments are not publicly traded, further judgments and estimates are required to determine their fair value. As a result, potential impairment charges to write-down such investments to net realizable value could adversely affect our future operating results.

While we have recognized all declines that are believed to be other-than-temporary, it is reasonably possible that individual investments in our portfolio may experience an other-than-temporary decline in value in the future if the underlying investee experiences poor operating results or the global equity markets experience future broad declines in value.

Realization of Deferred Tax Assets

At September 30, 2004, total net deferred tax assets were €644 million. Included in this total are the tax benefits of net operating loss and credit carry-forwards of approximately €352 million, net of

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the valuation allowance. These tax loss and credit carry-forwards generally do not expire under current law.

We have evaluated our deferred tax asset position and the need for a valuation allowance. The assessment requires the exercise of judgment on the part of our management with respect to, among other things, benefits that could be realized from available tax strategies and future taxable income, as well as other positive and negative factors. The ultimate realization of deferred tax assets is dependent upon our ability to generate the appropriate character of future taxable income sufficient to utilize loss carry-forwards or tax credits before their expiration. Since we have incurred a cumulative loss in certain tax jurisdictions over the three-year period ended September 30, 2004, the impact of forecasted future taxable income is excluded from such an assessment, pursuant to the provisions of Statement of Financial Accounting Standards (SFAS) No. 109.

For these tax jurisdictions, the assessment was therefore based only on the benefits that could be realized from available tax strategies and the reversal of temporary differences in future periods. As a result of this assessment, we recognized an additional deferred tax asset valuation allowance and charged tax expense in the 2003 and 2004 financial years of €182 million and €54 million, respectively, in order to reduce the deferred tax asset to an amount that is more likely than not expected to be realized in the future. We assess our deferred tax asset position on a regular basis. Our ability to realize deferred tax assets is dependent on our ability to generate future taxable income sufficient to utilize tax loss carry-forwards or tax credits before their expiration. As a result of recently incurred tax losses, we expect to continue to recognize low levels of deferred tax benefits in the 2005 financial year, until such time as taxable income is generated from operations in tax jurisdictions that would utilize our tax loss carry-forwards in those jurisdictions.

The recorded amount of total deferred tax assets could be reduced if our estimates of projected future taxable income and benefits from available tax strategies are lowered, or if changes in current tax regulations are enacted that impose restrictions on the timing or extent of our ability to utilize tax loss and credit carry-forwards in the future.

Purchase Accounting

We have acquired other businesses, including MIC in the 2002 financial year, SensoNor in the 2003 financial year and ADMtek in the 2004 financial year. These acquisitions resulted in aggregate in-process research and development costs of €52 million (including €9 million in the 2004 financial year) that were immediately recorded as expense in the respective periods of acquisition. Additionally, these acquisitions resulted in the generation of a significant amount of long-lived intangible assets.

Accounting for business combinations requires the allocation of the purchase price to identifiable tangible and intangible assets and liabilities based upon their fair value. The allocation of purchase price is highly judgmental, and requires the extensive use of estimates and fair value assumptions, which can have a significant impact on operating results.

Contingencies

We are subject to various legal actions and claims, including intellectual property matters, that arise in the normal course of business.

On September 15, 2004 we entered into a plea agreement with the U.S. Department of Justice in connection with its ongoing investigations of alleged antitrust violations in the DRAM industry. We agreed to pay a fine of $160 million over a five-year period. We are also subject to similar investigations by the European Commission and the Canadian Competition Bureau. We regularly assess the likelihood of any adverse outcome or judgments related to these matters, as well as estimating the range of possible losses and recoveries. Liabilities, including accruals for significant litigation costs, related to legal proceedings are recorded when it is probable that a liability has been incurred and the associated amount of the loss can be reasonably estimated. Where the estimated amount of loss is within a range of amounts and no amount within the range is a better estimate than any other amount or the range cannot be estimated, the minimum amount is accrued. Accordingly, we have accrued a liability and charged operating income in the accompanying consolidated financial statements related to certain asserted and unasserted claims existing as of each balance sheet date. As additional information becomes available, any potential liability related to

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these actions is assessed and the estimates are revised, if necessary. These accrued liabilities would be subject to change in the future based on new developments in each matter, or changes in circumstances, which could have a material impact on our results of operations, financial position and cash flows.

International Financial Reporting Standards (IFRS)

Pursuant to a regulation of the European Union (the EU), we will be required to report our consolidated financial statements in accordance with International Financial Reporting Standards (IFRS , formerly known as International Accounting Standards) with effect from October 1, 2007.

We are in the process of determining the impact of adopting IFRS with regard to:

- The analysis of key differences between IFRS and U.S. GAAP;
- The changes in disclosure requirements;
- The effect of new reporting requirements on previously reported figures and future results; and
- The impact on current business and procedures.

The objective of this process is to identify and establish accounting policies and practices that give a true and fair view of our company and its results of operations in accordance with IFRS.

We are not yet able to provide a quantitative analysis of the impact that the adoption of IFRS would have on our financial statements. The ultimate impact of adopting IFRS is further affected by the future issuance of final versions of IFRS standards that currently have draft status, and the degree of convergence achieved between U.S. GAAP and IFRS by the date of adoption. We expect to be able to meet the timetable set by the EU.

Qualitative and Quantitative Disclosure about Market Risk

The following discussion should be read in conjunction with Notes 2, 30 and 31 to our consolidated financial statements.

Commodity Price Risk

A significant portion of our business, namely the sales of our Memory Products segment, is exposed to fluctuations in DRAM market prices. DRAM is a highly standardized product and the sales price responds to market forces in a way similar to that of other commodities. DRAM price volatility can be extreme and has resulted in significant fluctuations within relatively short time-frames. We attempt to mitigate the effects of volatility by continually improving our cost position, by entering into new strategic partnerships and by focusing our product portfolio on application specific products that are subject to less volatility.

We are also exposed to commodity price risks with respect to raw materials used in the manufacture of our products. We seek to minimize these risks through our sourcing policies (including the use of multiple sources, where possible) and our operating procedures. We do not utilize derivative financial instruments to manage any remaining exposure to fluctuations in commodity prices.

Foreign Exchange Risk

Although we prepare our financial statements in euro, a major portion of our sales volumes as well as the costs relating to the design, production and manufacturing of products are denominated in U.S. dollars. Our activities in markets around the globe create cash flows in a number of different currencies. Exchange rate fluctuations may have substantial effects on our sales figures, our costs and our overall profits.

The table below provides information about our derivative financial instruments that are sensitive to changes in foreign currency exchange rates as of September 30, 2004. For foreign currency exchange forward contracts related to certain sale and purchase transactions and debt service payments denominated in foreign currencies, the table presents the notional amounts and the weighted average contractual foreign exchange rates. At September 30, 2004, our foreign currency forward contracts had terms of up to one year and the currency options had terms up to two years.

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Our cross-currency interest rate swap expires in 2005 and our interest rate swaps expire in 2007 and 2008. We do not enter into derivatives for trading or speculative purposes.

Derivative Financial Instruments(1)

	Contract amount buy/(sell)	Average contractual forward exchange rate	Fair value September 30, 2004
Foreign currency forward contracts :			
U.S. dollar	56	1.21548	(1)
U.S. dollar	(371)	1.20722	8
Japanese yen	55	134.65089	
Japanese yen	(4)	133.15200	
Singapore dollar	29	2.08514	
Great Britain pound	4	0.67672	
Other currencies	5		
Currency options:			
U.S. dollar	514	1.16833	9
U.S. dollar	(520)	1.15419	(16)
Cross-currency interest rate swap:			
U.S. dollar	406	1.10	60
Interest rate swap	1,442	n/a	29
Fair value, net			89

(1) Euro equivalent, in millions except for average contractual forward exchange rates.

Our policy with respect to limiting short-term foreign currency exposure generally is to economically hedge at least 75 percent of our estimated net exposure for a minimum period of two months in advance and, depending on the nature of the underlying transactions, a significant portion for the periods thereafter. Part of our foreign currency exposure cannot be mitigated due to differences between actual and forecasted amounts. We calculate this net exposure on a cash-flow basis considering balance sheet items, actual orders received or made and all other planned revenues and expenses.

We record our derivative instruments according to the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. SFAS No. 133 requires all derivative instruments to be recorded on the balance sheet at their fair value. Gains and losses resulting from changes in the fair values of those derivatives are accounted for depending on the use of the derivative instrument and whether it qualifies for hedge accounting. Our economic hedges are generally not considered hedges under SFAS No. 133. Under our economic hedging strategy we report derivatives at fair value in our financial statements, with changes in fair values recorded in earnings.

In the 2004 financial year foreign exchange transaction losses were €62 million and were offset by gains from our economic hedge transactions of €47 million, for net losses of €15 million. This compares to foreign exchange losses of €146 million, offset by hedging gains of €114 million, for net losses of €32 million in the 2003 financial year. A large portion of our manufacturing, selling and marketing, general and administrative, and research and development expenses are incurred in currencies other than the euro, primarily the U.S. dollar and Japanese yen. Fluctuations in the exchange rates of these currencies to the euro had an adverse effect on profitability in the 2003 and 2004 financial years.

Interest Rate Risk

We are exposed to interest rate risk through our debt instruments, fixed term deposits and loans. During the 2002 and 2003 financial years, we issued two convertible bonds. Due to the high volatility of our core business and to maintain high operational flexibility, we keep a substantial amount of

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cash and marketable securities. These assets are mainly invested in instruments with contractual maturities of between three and twelve months, bearing interest at short-term rates. To reduce the risk caused by changes in market interest rates, we attempt to align the duration of the interest rates of our debts and current assets by the use of interest rate derivatives.

Fluctuating interest rates have an impact on parts of both our marketable securities as well as our debt obligations and standby lines of credit. We make use of derivative instruments such as interest rate swaps to hedge against adverse interest rate developments. We have entered into interest rate swap agreements that mainly convert the fixed interest rate on our convertible bonds to a variable interest rate based on the relevant European Interbank Offering Rate (EURIBOR).

During the 2004 financial year we designated interest rate swap agreements with a notional amount of €500 million as fair value hedges of €500 million of our convertible notes due 2007, and thereby intend to lock in the effective amount of this portion of the convertible debt at its fair value. We further entered into and designated a forward interest swap agreements as a cash flow hedge, whereby we intend to lock in the effective cash amount of interest in the lease payments we expect to make during the first ten years under our Campeon lease agreement.

Subsequent Events

On November 10, 2004, we and ProMOS reached an agreement regarding ProMOS license of our previously transferred technologies, pursuant to which ProMOS may continue to produce and sell products using those technologies and to develop its own processes and products. As full consideration, ProMOS has agreed to pay $156 million in four instalments through April 30, 2006, against which our accrued payable for DRAM products purchased from ProMOS of $36 million is to be offset. The parties have agreed to withdraw their respective claims, including arbitration. We will recognize the relevant license income during the three months ending December 31, 2004.

Outlook

Leading market analysts have forecast a reduction of the rate of growth of the worldwide semiconductor market in U.S. dollars from nearly 30 percent during the 2004 calendar year to a single-digit average rate of growth during the 2005 calendar year. These forecasts imply stagnation in the industry with respect to sequential average quarterly growth for our 2005 financial year. Consistent with these forecasts, we see signs of a slowdown in several of our application segments during the first quarter of our 2005 financial year, mainly due to relatively high inventories in the supply chain for these markets at this time of year.

For the first quarter of the 2005 financial year, we anticipate the following with respect to our four principal segments:

- In the Wireline Communications segment we do not expect growth in the first quarter of our 2005 financial year due to continuing pricing pressure and marketplace inventory corrections, especially in the Asian market. The segment s EBIT loss for our 2005 financial year is expected to be significantly reduced if and when the sale of our fiber optics business to Finisar is completed.

- With signs of a slowdown and higher marketplace inventories, especially in the Asian mobile phone market, customers have started to significantly slow down new orders in the Secure Mobile Solutions segment. We therefore anticipate a significant reduction in revenues for the first quarter of the 2005 financial year, resulting in lower capacity utilization and margin pressure. As market research institutes predict a slowdown in growth of the mobile phone market for the 2005 calendar year, we are cautious about the development of sales volumes and expect lower utilization rates in manufacturing throughout our 2005 financial year.

- For automotive applications in the Automotive & Industrial segment we anticipate continuing price pressure and no major market changes in demand for semiconductors. We expect a slightly weaker market for industrial applications. Due to these developments, in combination with seasonal effects, we expect a slight reduction in revenues and earnings in the first quarter of our 2005 financial year.

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- For Memory Products we expect business to develop in line with seasonal demand during the first quarter of our 2005 financial year. Based on additional capacities from our Inotera joint venture and foundry partners, we anticipate an increase of bit production.

In our 2005 financial year, although we do not anticipate being able to decouple ourselves from the industry trends, we aim to achieve profitable growth by relentlessly focusing on better serving the needs of our customers, maintaining our cooperative culture, and continually improving our operational performance through our state-of-the-art manufacturing capabilities and leading-edge technologies.

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RISK FACTORS

You should carefully consider the risks described below before making an investment decision. The occurrence of any of the following events could harm us. If these events occur, the trading price of our company s shares could decline, and you may lose all or part of your investment. Additional risks not currently known to us or that we now deem immaterial may also harm us and affect your investment.

Risks related to the semiconductor industry

Our business could suffer from periodic downturns

The semiconductor industry is highly cyclical and has suffered significant economic downturns at various times. These downturns have involved periods of production overcapacity, oversupply, lower prices and lower revenues. The markets for memory products have been especially volatile.

According to WSTS, worldwide sales of all semiconductor products have fluctuated significantly over the past several calendar years. Sales decreased in 1996, 1998 and 2001, with a decrease of approximately 32 percent in 2001. Sales grew by 1 percent in 2002 and a further 18 percent in 2003. In October 2004, WSTS predicted a growth rate of 28 percent for the 2004 calendar year. Recent growth has, however, so far been accompanied by downward price pressure in some of our business segments, especially for some of the products from our Secure Mobile Solutions segment.

There can be no assurance that the market will stabilize or improve in the near term or that the growth rates experienced in recent periods will be attainable again in the coming years. A renewed downturn in the industry could result in further substantially reduced sales volumes or prices for our products, resulting in a severe adverse impact on our results of operations.

Industry overcapacity could require us to lower our prices, particularly for memory products

Both semiconductor companies with their own manufacturing facilities and semiconductor foundries, which manufacture semiconductors designed by others, have added significant capacity in recent years and are expected to continue to do so. In the past, the net increases of supply, meaning the difference of capacity additions less capacity reductions due to obsolescence, sometimes exceeded demand requirements, leading to oversupply situations and downturns in the industry. The table below shows revenue and bit data as well as year over year price per bit development for the DRAM market since 1994 (Source: WSTS).

Calendar Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
DRAM market in billion US$	23	41	25	20	14	21	29	11	15	17
DRAM market in billion megabits	8	13	23	46	87	163	258	420	590	823
Year over year change average price per bit	-3%	1%	-66%	-60%	-63%	-21%	-12%	-76%	-3%	-22%

According to WSTS market data, during the first nine months of the 2004 calendar year, the average selling price for DRAM increased by 3 percent compared to the 2003 calendar year. Downturns in the industry, including the most recent downturn period of 2001-2002, have severely hurt the profitability of the DRAM industry generally, including our DRAM business. The volatility of the semiconductor industry may at any rate lead to future downturns, which could have similar effects. Fluctuations in the rate at which industry capacity is growing relative to the growth rate in demand for semiconductor products may in the future put pressure on our average selling prices and hurt our results of operations.

Risks related to our operations

We may not be able to protect our proprietary intellectual property and may be accused of infringing the intellectual property rights of others

Our success depends on our ability to obtain patents, licenses and other intellectual property rights covering our products and our design and manufacturing processes. The process of seeking patent protection can be long and expensive. Patents may not be granted on currently pending or future applications or may not be of sufficient scope or strength to provide us with meaningful protection or commercial advantage. In addition, effective copyright and trade secret protection may

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be unavailable or limited in some countries, and our trade secrets may be vulnerable to disclosure or misappropriation by employees, contractors and other persons.

Competitors may also develop technologies that are protected by patents and other intellectual property rights. These technologies may therefore either be unavailable to us or be made available to us only on unfavorable terms and conditions. Litigation, which could cost us financial and management resources, may be necessary to enforce our patents or other intellectual property rights or to defend against claims of infringement of intellectual property rights brought against us by others. For example, Rambus Inc. filed suits against us in the United States and Germany in August 2000, alleging infringement of its intellectual property rights. Although we initially prevailed at the U.S. trial court proceedings, Rambus successfully appealed this decision, and the infringement action has been remanded for a new trial. The German case is still pending in the first instance. In 2002, MOSAID Technologies Inc. filed suit against us claiming that we violate certain of its DRAM patents. The final outcome of these suits may have a material adverse effect on our business. We may be forced either to stop producing substantially all of our memory products or to license the underlying technology upon economically unfavorable terms and conditions, and possibly to pay damages for prior use of the Rambus or MOSAID Technologies at issue. See Business Legal Matters Litigation for a more detailed description of these proceedings.

Our results may suffer if we are not able to match our production capacity to demand

During periods of industry overcapacity and declining selling prices, such as we have experienced, customers do not generally order products as far in advance of the scheduled shipment date as they do during periods when our industry is operating closer to capacity, such as in the 2003 and 2004 financial years. We therefore experience lower levels of backlog during such downturns, which makes it more difficult to forecast production levels and revenues.

It is difficult to predict future growth in the markets we serve, making it very difficult to estimate requirements for production capacity. If the market does not grow as we have anticipated, we risk under-utilization of our facilities. This may also in the future result in write-offs of inventories and losses on products whose demand is lower than current forecasts may indicate.

During periods of increased demand we may not have sufficient capacity to meet customer orders. Such constraints affect our customers ability to deliver products in accordance with their planned manufacturing schedules, making relationships with affected customers difficult. For example, we lost sales due to capacity constraints during 2000 as customers turned to other manufacturers that could satisfy their increased demand. We may face similar difficulties if and when capacity constraints recur.

In the past we have responded to fluctuations in industry capacity and demand by adapting production levels, closing existing production facilities, opening new production facilities or entering into strategic alliances. We have incurred high costs as a result. We have also purchased an increasing number of processed wafers from semiconductor foundries to meet higher levels of demand and have incurred higher cost of goods sold as a result. In order to expand or reduce our production capacity in the future, we may have to spend substantial amounts, which could hurt our results of operations.

Our business could suffer from problems with manufacturing

The semiconductor industry is characterized by the introduction of new or enhanced products with short life cycles in a rapidly changing technological environment. We manufacture our products using processes that are highly complex, require advanced and costly equipment and must continuously be modified to improve yields and performance. Difficulties in the manufacturing process can reduce yields or interrupt production, and we may not be able to deliver products on time or in a cost-effective, competitive manner.

We may not always be able to foresee and prepare for every contingency. If production at a fabrication facility is interrupted, we may not be able to shift production to other facilities on a timely basis or customers may purchase products from other suppliers. In either case, the loss of revenues and damage to the relationship with our customers could be significant.

Increasing our production capacity to reduce our exposure to potential production interruptions would increase our fixed costs. If we do not increase our net sales to meet these higher costs, our operating results could be harmed.

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We may at times outsource production of some of our products to third-party suppliers. Using third-party suppliers exposes us to manufacturing problems experienced by those suppliers and may be less cost-effective than manufacturing at our own facilities.

We have a limited number of suppliers and could suffer shortages if they were to interrupt supply or increase prices

Our manufacturing operations depend upon obtaining deliveries of equipment and adequate supplies of materials on a timely basis. We purchase equipment and materials from a number of suppliers on a just-in-time basis. From time to time, suppliers may extend lead times, limit supply to us or increase prices due to capacity constraints or other factors. Because the equipment that we purchase is complex, it is difficult for us to substitute one supplier for another or one piece of equipment for another. Some materials are only available from a limited number of suppliers. Although we believe that supplies of the materials we use are currently adequate, shortages could occur in critical materials, such as silicon wafers or specialized chemicals used in production, due to interruption of supply or increased industry demand. Our results of operations would be hurt if we could not obtain adequate supplies of quality equipment or materials in a timely manner or if there were significant increases in the costs of equipment or materials.

Our business could suffer if we do not have adequate access to capital

Semiconductor companies that operate their own manufacturing facilities require significant amounts of capital to build, expand, modernize and maintain them. Semiconductor companies also require significant amounts of capital to fund research and development. We used cash in our investing activities of €1,244 million in the 2002 financial year, €1,522 million in the 2003 financial year and €1,809 million in the 2004 financial year. Our research and development expenses were €1,060 million in the 2002 financial year, €1,089 million in the 2003 financial year and €1,219 million in the 2004 financial year. In response to severe downturns in our business in the 2001 financial year, we limited our capital expenditures substantially during our 2002 financial year to €643 million. In the 2003 financial year we increased our capital expenditures by 36 percent to €872 million. In 2004 our capital expenditures increased again by 33 percent to €1,163. We intend to continue to invest heavily in research and development and manufacturing facilities, while continuing our policy of cooperation with other semiconductor companies to share these costs with us. A prime example is our joint venture, Inotera, where together with our joint venture partner, Nanya, we have recently completed construction of a 300-millimeter manufacturing facility for memory products.

In the future, we may not be able to raise the amount of capital required for our business on acceptable terms due to a number of factors, such as general market and economic conditions, inadequate cash flow from operations or unsuccessful asset management. Our business may be hurt if we are not able to make expected capital expenditures and meet expected research and development expenses.

Our business could suffer if we are not able to secure the development of new technologies or if we cannot keep pace with the technology development of our competition

The semiconductor industry is characterized by rapid technological changes. New process technologies using smaller feature sizes and offering better performance characteristics are introduced to manufacturing every one to two years. The introduction of new technologies allows us to increase the functionalities per chip while at the same time optimizing performance parameters, such as decreasing power consumption or increasing processing speed. In addition, the reduction of feature sizes allows us to produce smaller chips offering the same functionality and thereby considerably reduce the costs per function. In order to remain competitive, it is essential that we secure the capabilities to develop and qualify new technologies for the manufacturing of new products. For example all of our DRAM products are manufactured based on so-called trench technology. If we are unable to secure our capabilities to develop and qualify this technology and products based thereon, our business may suffer.

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The Siemens group is our largest customer and our results could suffer if it were to reduce its level of purchases from us

In the 2002, 2003 and 2004 financial years 14 percent, 14 percent and 13 percent, respectively, of our net sales resulted from direct sales to the Siemens group, including a minor amount of sales through the Siemens group s sales organization for resale to third parties. We expect the Siemens group to continue to be one of our largest customers, but we cannot assure you that it will continue purchases at the same level as in the past. Our results could be harmed if the Siemens group purchases less from us in the future and other customers do not increase their orders to make up the shortfall.

We rely on our strategic partners, and our business could be harmed if these alliances were to be terminated

As part of our strategy, we have entered into a number of long-term strategic alliances with leading industry participants, both to manufacture semiconductors and to develop new manufacturing process technologies and products. If our strategic partners encounter financial difficulty, they may no longer be able to participate in our alliances. Some of the agreements governing our strategic alliances allow our partners to terminate the agreement if our equity ownership changes so that a third party other than the Siemens group gains control of our company or of a significant portion of our company s shares. Our business could be harmed if any of our strategic partners were to discontinue its participation in a strategic alliance or if the alliance were to otherwise terminate.

Our business could suffer as a result of volatility in different parts of the world

We operate globally, with numerous manufacturing, assembly and testing facilities on three continents, including four that we operate jointly with partners. In the 2004 financial year, 77 percent of our revenues were generated outside Germany and 59 percent were generated outside Europe. Our business is therefore subject to risks involved in international business, including:

- negative economic developments in foreign economies and instability of foreign governments, including the threat of war, epidemic or civil unrest;
- changes in laws and policies affecting trade and investment; and
- varying practices of the regulatory, tax, judicial and administrative bodies in the jurisdictions where we operate.

Substantial changes in any of these conditions could have an adverse effect on our business and results of operations. For example, the economic slowdown in Asia in 1997 and 1998, and the worldwide economic downturn from 2001 to 2003, reduced demand for semiconductors, and we suffered losses due to the resulting fall in sales volumes and semiconductor prices. Our results of operations could also be hurt if demand for the products made by our customers decreases due to adverse economic conditions in any of the regions where they sell their own products.

Our business can be hurt by changes in exchange rates

Our results of operations can be hurt by changes in exchange rates, particularly between the euro and the U.S. dollar and the Japanese yen. Many of our receivables are denominated in U.S. dollars, while our payables are denominated largely in euro. In addition, the balance sheet impact of currency translation adjustments has been, and may continue to be, material.

We had foreign currency derivative and transaction losses of €16 million in the 2002 financial year€32 million in the 2003 financial year and€15 million in the 2004 financial year.

Since its introduction in 1999, the euro has fluctuated in value against the U.S. dollar, ranging from a high of €1.00 = $1.3090 in November 2004 to a low of €1.00 = $0.8252 in October 2000. The relative weakness of the euro against the dollar positively affected our revenues and results of operations in the 2002 financial year. Since the beginning of 2003, the dollar has weakened sharply against the euro, which has had a substantial negative effect on our revenues and profitability. On November 23, 2004, the exchange rate was €1.00 = $1.3090. Any further weakening of the dollar against the euro would further negatively affect our results of operations.

Environmental laws and regulations may expose us to liability and increase our costs

Our operations are subject to many environmental laws and regulations wherever we operate governing, among other things, air emissions, wastewater discharges, the use and handling of

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hazardous substances, waste disposal and the investigation and remediation of soil and ground water contamination. A directive in the European Union imposes a take-back obligation on manufacturers to finance the collection, recovery and disposal of electrical and electronic equipment. This directive is currently being implemented in the Member States and will come into force in August 2005. Additional European legislation will ban the use of lead and some flame retardants in electronic components beginning in July 2006. Furthermore, a legislative proposal by the European Commission deals with the registration, evaluation and authorization of chemicals (REACH). The Commission has also made a legislative proposal on the ecological design of electrical appliances, including the components of electrical appliances, which would create an obligation to conform to the so-called CE rules. These directives, and the REACH proposal, if adopted, may complicate our research and development activities and may require us to change certain of our manufacturing processes, to utilize more costly materials or to incur substantial additional costs.

As with other companies engaged in similar activities, we face inherent risks of environmental liability in our current and historical manufacturing locations. In the 2004 financial year, the EU directive on environmental liability came into force. After implementation, we will face increased environmental liability, which may result in higher insurance costs and potential damage claims. Costs associated with future additional environmental compliance or remediation obligations could adversely affect our business.

For a further description of environmental issues that we face see Business Environmental Protection and Sustainable Management .

Reductions in the amount of government subsidies we receive or demands for repayment could increase our reported expense or limit our ability to fund our capital expenditures

As is the case with many other semiconductor companies, our reported expenses have been reduced in recent years by various subsidies received from governmental entities. In particular, we have received, and expect to continue to receive, subsidies for investment projects as well as for research and development projects. We recognized governmental subsidies as a reduction of R&D expense and cost of sales in an aggregate amount of €93 million in the 2002 financial year, €113 million in the 2003 financial year and €160 million in the 2004 financial year. In addition, we reduced the carrying value of fixed assets by €17 million and €49 million during the 2003 and 2004 financial years, respectively.

As the general availability of government funding is outside our control, we cannot assure you that we will continue to benefit from such support, that sufficient alternative funding would be available if necessary or that any such alternative funding would be provided on terms as favorable to us as those we currently receive.

The application for and implementation of such subsidies often involves compliance with extensive regulatory requirements, including, in the case of subsidies to be granted within the European Union, notification to the European Commission of the contemplated grant prior to disbursement. In particular, establishment of compliance with project-related ceilings on aggregate subsidies defined under European Union law often involves highly complex economic evaluations. If we fail to meet applicable formal or other requirements, we may not be able to receive the relevant subsidies or may be obliged to repay them, which could have a material adverse effect on our business.

The terms of certain of the subsidies we have received impose conditions that may limit our flexibility to utilize the subsidized facility as we deem appropriate, to divert equipment to other facilities, to reduce employment at the site, or to use related intellectual property outside the European Union. This could impair our ability to operate our business in the manner we believe to be most cost effective.

We have entered into a plea agreement with the U.S. Department of Justice in connection with its investigation of pricing practices in the DRAM industry, and we continue to be subject to investigation in other jurisdictions and to civil claims in connection with this matter

In September 2004, we entered into a plea agreement with the Antitrust Division of the U.S. Department of Justice (DOJ) in connection with its ongoing investigation of alleged antitrust violations in the DRAM industry. Pursuant to this plea agreement, we agreed to plead guilty to a single count relating to the pricing of DRAM products between July 1, 1999 and June 15, 2002.

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Under the terms of the agreement, we agreed to pay a fine of $160 million. The fine plus accrued interest is to be paid in equal annual instalments through 2009. On October 25, 2004 the plea agreement was accepted by the U.S. District Court for the Northern District of California. The matter has therefore been fully resolved between us and the DOJ, subject to our ongoing obligation to cooperate with the DOJ in its ongoing investigation of other participants in the DRAM industry. The wrongdoing charged by the DOJ was limited to six OEM customers that manufacture computers and servers. We have entered into settlement agreements with five of these customers and are negotiating a settlement with the remaining customer.

Following the opening of the DOJ s investigation, a number of purported class action lawsuits were filed against us and other DRAM suppliers in U.S. federal courts and in state courts in various U.S. states. The complaints allege violations of federal and state antitrust and competition laws and seek significant damages on behalf of the plaintiffs.

In April 2003, we received a request for information from the European Commission (the Commission) to enable the Commission to assess the compatibility with the Commission s rules on competition of certain practices of which the Commission has become aware in the European market for DRAM memory products. In May 2004, the Canadian Competition Bureau advised our U.S. subsidiary that it and its affiliated companies are among the targets of a formal inquiry into alleged violations of the Canadian Competition Act in the DRAM industry. No compulsory process (such as subpoenas) has been commenced. The Competition Bureau s inquiry is at a relatively early stage. We are cooperating with the Commission and the Competition Bureau in their inquiries.

In connection with these matters and in accordance with U.S. GAAP, we established an accrual of €28 million in the fourth quarter of the 2003 financial year and made further accruals aggregating €209 million in the 2004 financial year. As noted above, we have agreed to pay a fine of $160 million in connection with the DOJ investigation. Because the other matters remain ongoing, we cannot predict at this time whether the reserves will be adequate to cover any further potential liabilities that we may incur.

An adverse final resolution of the civil antitrust claims or the Commission or Canadian investigations described above could result in significant financial liability to, and other adverse effects upon, us, which would have a material adverse effect on our business, results of operations and financial condition. Irrespective of the validity or the successful assertion of the above-referenced claims, we could incur significant costs with respect to defending against or settling such claims, which could have a material adverse effect on our results of operations or financial condition or cash flows. See Business Legal Matters Litigation for a description of these matters.

Purported class action lawsuits have been filed against us alleging securities fraud

Following our announcement in September 2004 of our agreement to plead guilty in connection with the DOJ s antitrust investigation and to pay a fine of $160 million, several purported class action lawsuits have been brought against us in the U.S. district courts. These suits allege, among other things, that we fraudulently overstated our revenues in connection with the practices investigated by the DOJ. We intend to defend these suits vigorously. A significant settlement or negative outcome at trial could have a material adverse effect on our financial results. See Business Legal Matters Litigation for a description of these matters.

We might be faced with product liability or warranty claims

Despite extensive quality assurance measures, there remains a risk that defects may occur in our products. The occurrence of such defects could give rise to warranty claims or to liability for damages caused by such defects and for consequential damages and could, moreover, impair the market s acceptance of our products. Both could have a material adverse effect on our business and financial condition. Also, customers have from time to time notified us of potential contractual warranty claims in respect of products supplied by us, and may do so in the future. See Business Legal Matters Litigation for a description of these and other proceedings.

We may be unable to successfully integrate businesses we acquire

We have acquired other businesses, including Ericsson Microelectronics in September 2002, SensoNor in June 2003 and ADMtek in April 2004. We intend to continue acquisitions of, and investments in, other companies in the future. We face risks resulting from the expansion of our

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operations through acquisitions. These include the risk that we might be unable to integrate new businesses with our culture and strategies. We also cannot be certain that we will be able to achieve the benefits we expect from a particular acquisition or investment. Acquisitions may also strain our managerial and operational resources, as the challenge of managing new operations may divert our managers and employees from monitoring and improving operations in our existing businesses. Our business, financial condition and results of operations may suffer if we fail to coordinate our resources effectively to manage both our existing businesses and any businesses we acquire.

In the 2003 financial year we expensed €68 million to reduce the goodwill associated with our acquisition of Catamaran Communications because the amount of cash we expect to receive in the future from this business is less than what we expected at the time we made the acquisition. We reduced our expectations because of recent changes in the market environment and their effects over the period for which we can reasonably forecast the future development in the market. In the 2004 financial year we expensed an additional €71 million as a further reduction of goodwill because our expectations of the future market development had changed. We review acquired goodwill for impairment at least once a year. Changes in our expectations in the future due to changes in market developments which we cannot currently foresee could result in our writing off additional amounts of goodwill in future periods.

Siemens exercises partial control over some of our intellectual property rights and could use these rights to compete with us

In connection with our formation as a legal entity, Siemens transferred approximately 20,000 patent rights to us. Under the terms of this transfer and related agreements, however, Siemens retained the right to use these patent rights within the scope of its business for an unlimited period of time, subject to various restrictions in the case of patents relating to information handling systems. A non-competition agreement between us and Siemens, entered into in connection with our formation as a separate company, expired in March 2004. Siemens is no longer prevented from competing with us, and may utilize the patent rights it retained at the time of our formation to do so.

Siemens also retained the right to assert infringement claims against third parties with respect to approximately 15 percent of the patent rights that it transferred to us, insofar as these patents relate to the technical field of the Siemens group s business activities. Siemens has agreed that it will not exercise this right against any of our customers in respect of any part of such customer s products that contains one of our products, unless this right is asserted for defensive purposes. Nevertheless, we can provide no assurance that these safeguards will be sufficient to protect all of our customers against claims by Siemens with respect to those of their products that incorporate technology covered by these patents. It may therefore be difficult for us to sell our products or grant licenses of these patents to third parties, and they may not be able to use our products without infringing these patents or incurring license fees to Siemens.

Sales by Siemens of substantial number of shares in the public market could adversely affect the market price of the shares and ADSs

Siemens AG has the right, directly or indirectly, to direct the disposition of up to 136,292,363 shares of our company, representing approximately 18 percent of the currently issued shares of our company. These shares are currently held by Wachovia Trust Company in trust for the benefit of Siemens AG and may be transferred back to Siemens AG in December 2004. Siemens has announced publicly its intention to divest its ownership interest in our company through direct or indirect sales, as and when business and market conditions permit. Any such disposal could occur at any time or from time to time. Sales of substantial numbers of the shares of our company controlled by Siemens either in the public market or in private transactions, or the perception that such sales may occur, could adversely affect the market price of the shares and ADSs and could adversely affect our ability to raise capital through subsequent offerings of equity.

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BUSINESS

Overview

Industry Background

Semiconductors are the key building blocks used to create an increasing variety of electronic products and systems. Over the years, continuous improvements in semiconductor process and design technologies have led to ever smaller, more complex and more reliable devices at a lower cost per function. As performance has increased and size and costs have decreased, semiconductors have become common components in products used in everyday life. Semiconductors have expanded from their original primary applications in defense systems and mainframe computers to applications such as personal computers, telecommunications systems, automotive products, industrial automation and control systems and security applications.

Semiconductor sales have increased significantly over the long term, as the broader electronics industry has grown. Additional factors contributing to long-term growth include:

- the development of new semiconductor applications;
- the replacement of mechanical components with electronic components;
- increased demand for mobility, which requires increasing miniaturization and reduced power consumption; and
- demand for new products that have improved functionality and ease of use.

These factors have resulted in semiconductors constituting an increasing percentage of the total cost of the systems and products in which they are incorporated. According to IC Insights, the percentage of semiconductor content in electronic equipment increased from approximately 11 percent in 1989 to approximately 19 percent in 2003. Nevertheless, the market for semiconductors has historically been volatile. Supply and demand have fluctuated cyclically and have caused pronounced fluctuations in prices and margins. Following a severe downturn in 2001, the industry experienced a further period of low demand and ongoing worldwide overcapacity during 2002 and into 2003. During our 2004 financial year, the world semiconductor market once again experienced a (dollar-based) growth rate above the historical average.

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Types of Semiconductors

Semiconductors consist of a material such as silicon or gallium arsenide that can act as a switch allowing electrical current to flow under some conditions but not others. Semiconductors fulfill a wide range of functions in an increasing variety of applications. The technologies employed vary depending upon the function for which the semiconductor is used. The following chart describes the main types of semiconductors and their functions and gives examples of how each different type is used in a mobile telephone, a typical consumer product using semiconductors:

The different types of semiconductors may also be classified by a number of other technical characteristics:

- Integration, or the extent to which different circuits are combined on a single chip.

  Semiconductors may be either discrete devices, which have a low level of integration, or ICs, which can have thousands or millions of devices combined on a single chip.

- Customization, or the extent to which the design of a semiconductor is specific to a particular use.

  Standard components are semiconductors that are not customized and that can be used for a wide range of applications. Application-specific ICs (commonly referred to as ASICs) are customized semiconductors that are designed to perform particular functions in specific applications for particular customers. ASICs can be further classified into three groups according to their level of customization: full-custom devices, semi-custom devices and application-specific devices.

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- Whether the semiconductor uses analog, digital or mixed signal technology.

Analog signals are real world phenomena such as temperature, sound, light or pressure that vary over a continuous range of values. For example, an analog semiconductor can transform sounds into electrical signals or vice versa. Analog semiconductors collect, monitor, condition or transform analog signals into electrical signals and vice versa.

Digital signals are created by switching electrical current on or off. They vary based on the sequence of these on and off electrical pulses, which are frequently represented by ones and zeros. Digital signals are used in computer-like functions and calculations. A digital semiconductor stores information from digital signals or performs functions on digital signals. Examples of digital semiconductors would be memory chips or microprocessors.

Historically, digital semiconductors have been used primarily in computer systems, sophisticated computer networks and communications systems. In recent years, increasing demand for more powerful personal computers and networks used by a greater number of users, and new communications tools whose main components are digital semiconductors, have led to dramatic increases in the total number of devices that use semiconductors and in the total number of semiconductors used in each such device. To meet this demand, significant advances in electronic system integration have occurred in the design and manufacture of digital devices.

Digital devices can be used either to store or to process data. ICs that store data are referred to as memory ICs, and ICs that process data are referred to as logic ICs. DRAM ICs are examples of memory ICs. Memory ICs tend to be standardized products, used in high volume and differentiated by cost, performance, capacity, size, power consumption and speed. Logic ICs are more differentiated than memory ICs and require a greater variety of intellectual property and more sophisticated design.

Mixed-signal ICs combine analog and digital devices on a single chip to process both analog signals and digital data. Historically, analog and digital devices have been developed separately, and it has been technically difficult to combine them on a single chip. However, system designers are increasingly demanding system-level integration containing both analog and digital functions on a single chip. This allows chips to achieve increased functionality and speed for new applications such as multimedia and reduced power consumption for mobile applications.

History and Strategy

We have been a publicly traded company since March 2000, and were organized as a separate legal entity within the Siemens group with effect from April 1, 1999. Prior to that date, we were the Siemens Semiconductor Group. As such, we have been actively involved in the development, manufacture and marketing of semiconductors since 1952. We believe that we inherited from the Siemens Semiconductor Group a strong base of technology and experience in the semiconductor industry.

As Siemens Semiconductor Group, we pioneered the development of ICs for use in consumer products in the early 1960s. We produced the first radio-frequency chip set that was GSM-compatible in 1990. In 2000, we introduced and commenced deliveries of a mobile telephone chipset for the Bluetooth standard, introduced the first dual mode GPRS/GSM single baseband chip, and received the first certification for a complete Bluetooth system. In 2001, we introduced the first OC-192 single-chip 10-Gigabit-per second transceiver in silicon-germanium for high-speed SONET communications networks. In 2002, we successfully ramped up manufacturing of 256-Mbit DRAM memory chips produced on a 300-millimeter wafer and in 2003, developed the smallest 1-Gbit DRAM memory chip in 110-nanometer technology. In 2004, we were the first semiconductor company to provide single-chip UMTS RF transceivers in high volume, and presented in cooperation with IBM the world s first 16-Mbit MRAM chip. According to IC Insights, we were the fifth largest semiconductor company in the first half of the 2004 calendar year.

Our strategic objective is to achieve profitable growth by targeting fast-growing areas of the semiconductor industry and building upon our position as a leading innovator within the

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semiconductor industry. We aim to increase our market share and become one of the most profitable semiconductor companies in the world. We also seek to be among the top three suppliers of products in each of our business segments and to be the number one supplier of systems solutions. Specifically, we intend to:

- ***Focus on providing technological solutions to meet the needs of a modern lifestyle.*** The development of new semiconductor products has always been primarily technology driven; the technical possibilities have set the standard for development. In the future, we believe that the needs of individual consumers will determine the new trends in technology, as consumers demand solutions that improve the quality of life. Many of these solutions will be based on semiconductors, integrated with software and services into new platforms. In creating these solutions, we will focus on enhancing our existing semiconductor know-how in such areas as hardware and software design and system-on-chip integration as well as such promising new fields as nanotechnology, micro-mechanical systems and life sciences. In the future, we intend to combine our technical expertise in the areas of mixed signal, radio frequency, power semiconductor, microcontroller and digital signal processor architecture with software products and consulting and systems integration services, in order to better serve the needs of our customers.

- ***Build on our leadership in fast-growing areas served by our different segments.*** Our goal is to achieve profitable revenue growth greater than that experienced by the semiconductor industry generally. We seek to do this by increasing market share and exploiting opportunities that allow us to achieve a leadership position in rapidly growing segments of each of the markets our business groups address. We believe that our strong relationship with leading customers in all of our business areas gives us significant competitive advantages.

- ***Share risk and expand our access to leading-edge technology through long-term strategic partnerships with other leading industry participants.*** We believe that close relationships with other semiconductor companies allow us to share risks, reduce development costs and improve time-to-market. They also enable us to enhance our portfolio of intellectual property through worldwide access to the expertise of other industry participants. We intend to continue to develop long-term strategic relationships with leading industry participants, both to manufacture products and to develop new process technologies and products.

- ***Enhance our position in significant global markets.*** We currently develop, manufacture, market and sell products in Europe, North America, Japan and the Asia/Pacific region. An important element of our growth strategy is to further penetrate those international markets that we believe have the greatest growth potential over the coming years. We intend to position Infineon as one of the leading suppliers in China and the United States, to strengthen our position in Japan, and to further strengthen our leading position in Europe and the rest of the Asia/Pacific region.

- ***Enhance our position as an innovation and technology leader by continuing to invest in research and development.*** We believe that research and development is integral to the implementation of our overall strategy and essential to maintaining close relationships with our customers. Innovation will remain one of our top priorities for the future.

- ***Retain senior management and other highly qualified personnel, in particular R&D personnel, by fostering employee ownership of our shares***. In order to carry out our strategy, we must continue to attract and retain highly-qualified and motivated employees. We have therefore developed incentive plans and personnel development programs designed to encourage, recognize and reward superior technical expertise throughout Infineon. By offering selected employees the opportunity to participate in share ownership, we seek to ensure the alignment of the interests of our most qualified employees with those of our shareholders.

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Products and Applications

We are organized into four principal segments, three of which are application focused Wireline Communications, Secure Mobile Solutions and Automotive & Industrial; and one of which is product-focused Memory Products. These groups design, develop, manufacture and market a broad range of semiconductors and complete systems solutions used in a wide variety of microelectronic applications. During the 2004 financial year, we moved certain businesses from the Secure Mobile Solutions segment to the Automotive & Industrial segment. The following table gives an overview of some of the more significant products and applications and the four largest customers of each of our segments.

Principal Products, Applications and Customers

Segment	Principal Products	Principal Applications	Four Largest Customers in the 2004 Financial Year
Wireline Communications	ICs for Traditional Telecom (CODECs, SLICs, ISDN, E/T, etc); Broadband access solutions for DSL CO/CPE and VoIP; System solutions for modems, routers, gateways, WLAN access points, and NICs; ICs and modules for optical networks; Ethernet over Sonet (EoS) multi-service framer	Traditional Telecom, Broadband Access, Customer Premise Equipment (CPE), Optical Networks	Avnet Ericsson Siemens Tyco
Secure Mobile Solutions	Baseband ICs, application processors, RF transceivers, mobile phone system solutions, RF-power transistors, security memory ICs, security microcontroller ICs, encryption ICs, Trusted Platform Modules (TPM), RFID ICs	Mobile telephone systems and cordless telephone systems (major standards are: GSM, GPRS, UMTS, WDCT, DECT and Bluetooth) as well as WLAN, wireless infrastructure, RFID systems, security systems, chip cards for SIM cards, payment cards and identification cards andtransportation	Ericsson Gemplus Nokia Siemens
Automotive & Industrial	Power semiconductors (discretes, ICs and modules), sensors and microcontrollers (8-bit, 16-bit, 32-bit) with and without embedded memory, silicon discretes	Automotive: Powertrain (engine control, transmission control), body and convenience (comfort electronics, air conditioning), safety and vehicle dynamics (ABS, airbag, stability control), infotainment (wireless communication, telematics/navigation). Industrial: Power management & supplies, drives and power distribution	Avnet Bosch SAC Siemens

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Segment	Principal Products	Principal Applications	Four Largest Customers in the 2004 Financial Year
Memory Products	Commodity DRAM components with densities from 64-Mbit to 1-Gbit and SDRAM, DDR and DDR2 interfaces; mainstream modules for desktop and notebook PCs; special modules for workstations and servers.	Desktop and notebook computers, PC upgrades, workstations and servers, communications equipment, computer peripherals	Dell HP IBM Kingston
	Speciality DRAMs for graphics and mobile applications,	Graphic cards, PDAs, mobile phones, digital still cameras	
	NAND-compatible Flash components and SD-Flash Cards	Removable solid state memory cards, USB sticks, digital still cameras	

Wireline Communications

Our Wireline Communications segment designs, develops, manufactures and markets semiconductor solutions for the wireline communications market. This market is currently characterized by:

- a growing demand for a single network offering voice, video and data (triple play) applications, which we believe is driving growth of the Internet and will create increasing demand for high performance broadband access products;
- the convergence of voice and data networks into a single Internet Protocol network infrastructure, which we believe will drive demand for DLC products, particularly in the North American market; and
- increased investment by carriers in MAN (Metropolitan Area Network) core infrastructure to support increased data bandwidth requirements.

We focus on broadband access solutions for Central Office and Customer Premises. According to industry data, we were the number five supplier of wireline communications ICs worldwide in 2003, with a 6 percent market share (Gartner Dataquest, June 2004).

The primary applications for our Wireline Communications devices include

- traditional telecom and enterprise, e.g. analog line cards, ISDN, T/E, PBX, etc.,
- broadband access solutions for central office and customer premises equipment (xDSL),
- home networking equipment such as routers, gateways, WLAN access points, NICs, and
- optical networks

We are a leading supplier of traditional telecom solutions including analog line cards, ISDN, T/E, and our broadband access solutions enable combined solutions for voice and data applications. This portfolio of products allows a complete, end-to-end access solution that enables the triple play of voice, video, and data applications.

Focusing our efforts on providing complete solutions, we continually seek to increase our system solution offerings. Leveraging our leadership in voice access in combination with our digital design capabilities, we offer high-performance integrated voice and data (IVD) solutions and high-quality voice applications implementing our Geminax-Max and VINETIC™ ICs. To meet the market demand for broadband access solutions with Internet Protocol (IP) capabilities, we added our ConverGate™ IC to enable IP-DSLAM Linecard designs for both ADSL and SHDSL, using our Geminax-Max (ADSL) or SOCRATES™ (SHDSL) chip sets. To enable IP traffic over this IP-DSLAM Linecard, we use our Ethernet LAN card based on Purple, a high port density (24 and 48 ports) 10/100 Ethernet switching IC. Together with the latest released LR-VDSL6100i Modem on Chip (MoC), Purple is used as a core switching technology to provide Ethernet over VDSL solutions

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for the access segment. If used with our MetroMapper™ it provides a switching solution for the connection of the Metro Ring to the Central Office. Our optical networking products focus on the Metro Ring environment.

ADMtek, which we acquired in April 2004, complements our access systems, enabling us to provide end-to-end access solutions from the Central Office to the customer premises. Our customer premises equipment (CPE) unit provides low cost Ethernet switches and Ethernet PHYs, wired and wireless LAN NICs, low power consumption network processors and controllers, and xDSL modems.

Secure Mobile Solutions

Our Secure Mobile Solutions segment designs, develops, manufactures and markets a wide range of ICs for wireless applications, security controllers, security memories and other semiconductors and complete system solutions for wireless and security applications. This segment is one of the leading players in the market for semiconductor solutions for mobile phones and chip cards.

Our principal products include baseband and application processor ICs, standard and customized radio-frequency products, security memory ICs, security microcontroller ICs for SIM cards, payment cards, identification cards and transportation cards, Trusted Platform Modules (TPM), radio frequency identification (RFID) ICs, Bluetooth devices WLAN ICs and high frequency components for wireless infrastructure (Basestations). Our principal solutions include hardware system design and software solutions for mobile telephone systems (addressing primarily the GSM, GPRS, EDGE, and UMTS standards) and Bluetooth as well as DECT/WDCT, WLAN, RFID systems and security systems.

According to Gartner Dataquest, in the 2003 calendar year we remained the market leader in ICs for smart card applications, with a market share of 41 percent, and remained the market leader for RF transceiver devices in wireless communication, with a market share of 16 percent. We believe we will remain the leader in both markets in 2004. According to Gartner Dataquest we increased our market share in Wireless Communication Systems ASSPs (Application Specific Standard Products) to 7 percent, making us the number three supplier worldwide.

The markets for products in which our cellular communications ICs and systems are utilized are characterized by trends towards lower cost, increasingly rapid succession of product generations and increased system integration. Increasing demand for add-on applications such as multimedia is expected to increase the IC content of mobile phones. We expect these trends to create further opportunities for suppliers of cellular communication semiconductors and systems. The markets for our security products are characterized by trends towards lower prices, higher demand for embedded non-volatile memory in SIM cards and increasing security requirements, especially in payment and identification applications.

We offer products and solutions to customers in the following principal application segments:

Communications. We offer products and solutions in the following key segments of the wireless communications market:

- GSM, or Global System for Mobile communication, which is the de facto wireless telephone standard in Europe and is available in 120 countries. GSM is part of an evolution of wireless mobile telecommunication that includes High-Speed Circuit-Switched Data (HCSD), General Packet Radio System (GPRS), Enhanced Data GSM Environment (EDGE), and Universal Mobile Telecommunications Service (UMTS). We offer products and solutions addressing all of these wireless communications standards. In 2004, we introduced multimedia baseband ICs S-Gold and S-Goldlite for GSM/GPRS/EDGE mobile phone standards, entry phone baseband E-Goldlite for GSM/GPRS, the first single chip CMOS transceiver Smarti SD for cost-optimized GSM/GPRS mobile phones and silicon based BAW filters for performance optimized applications in CDMA and UMTS mobile phones.

- UMTS is a GSM-based standard for third-generation (3G) broadband, packet-based transmission of text, digitized voice, video, and multimedia at data rates up to 2 megabits per second (Mbps) offering a consistent set of services to mobile computer and phone users no matter where they are located in the world. We offer a complete 3G multimedia mobile phone platform for UMTS/EDGE/GPRS.

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- Bluetooth™ is a computing and telecommunications industry specification that allows mobile phones, computers, and personal digital assistants (PDAs) to easily interconnect with each other and with home and business phones and computers using a short range wireless connection. In the Bluetooth segment, we offer our BlueMoon Single and BlueMoon Universal products.

- WLAN, or wireless LAN, is a technology that permits the user of a wireless-enabled laptop or other mobile device to connect to a local area network, or LAN, through a wireless connection. We currently offer a complete WLAN solution, including chipset, evaluation boards, reference designs, firmware and software drivers, and full customer support.

- For secure communication applications, we provide chip card IC solutions for mobile communication and for pre-paid cards for public telephones. Currently, approximately every third SIM card shipped worldwide contains an Infineon chip.

- For wireless infrastructure applications we provide primarily RF components for mobile base stations. In 2004 we introduced an RF power transistor in new GOLDMOS technology for base stations for leading mobile phone standards, including UMTS/WCDMA/GSM/CDMA.

Computing. To customers in the computing segment, we offer products and solutions for both computing and large-scale identification projects. To enable secure computing platforms, our products and solutions are designed to prevent unauthorized use of digital terminals or to secure the data communication between the transmitter and receiver against manipulation. On a PC motherboard, our Trusted Platform Module (TPM) recognizes and prevents unauthorized access to stored data and attempted attacks by virus programs.

To customers in the identification segment, we offer security chips for identity documents, such as identity cards, passports or drivers licenses, insurance certificates and other documents. We supply security controllers for high-volume identification projects worldwide, including the U.S. Department of Defense Common Access Card, the Taiwanese electronic health card, the Hong Kong electronic ID card and the Indian electronic health card.

Consumer. We address the consumer sector, comprising payment, transport, digital and pay-TV, set-top boxes for multi-media use of televisions and Internet applications with a product portfolio addressing both wireless devices and security applications.

We offer security chips used to quickly verify the validity of electronic tickets, such as those used in local public transport systems or as tickets for events. For the payment segment, our security chip card controllers perform all of the functions required to issue a qualified electronic signature, enabling a debit or credit card holder to complete a purchase electronically. At the initiative of the Europay MasterCard Visa (EMV) international payment association, we are participating in a collaborative effort to reduce card fraud and provide cardholders with access to expanded services by transitioning from magnetic stripe to smart card technology. The EMV migration is rapidly changing banking and financial processes within Europe.

Industrial. Our radio frequency identification, or RFID, chips are used for applications in which it is necessary to identify and manage objects and goods quickly and reliably, or to track their positions, such as goods in transit or in warehouses. The RFID method can considerably reduce logistics expenditures. We offer complete RFID solutions.

Automotive & Industrial

The Automotive & Industrial segment designs, develops, manufactures and markets semiconductors and complete chipset solutions for use in automotive and industrial applications. According to Strategy Analytics, in the 2003 calendar year, our share of the automotive semiconductor market, in which there is a large number of suppliers, increased to almost 9 percent. In 2003, we were the second largest producer of ICs for automotive electronics worldwide and the largest in Europe. Within the fragmented market for industrial semiconductor applications, we focus on power management and supply as well as drives and power distribution.

The markets for both automotive and industrial semiconductors generally consist of four basic product classes: sensors, microcontrollers, power ICs and discrete semiconductors. Our Automotive & Industrial segment focuses on microcontrollers and power semiconductors, discrete semiconductors,

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modules and sensors. Power semiconductors handle higher voltage and higher current than standard semiconductors. The Automotive & Industrial segment works closely with our other segments to offer customers a complete semiconductor system solution, in the engine management, safety and chassis, body and convenience and telematics markets, in some cases including software.

In June 2004, IMS Research announced that we had the No.1 position in the worldwide market for power semiconductors, with a market share of over 8 percent in the 2003 calendar year.

To concentrate on commodity products in one segment, we decided to transfer our silicon discretes business unit from the Secure Mobile Solutions segment to the Automotive & Industrial segment, effective July 2004. The transferred businesses consist of a broad range of mostly discrete semiconductors like general purpose transistors and diodes, RF transistors and diodes, RF MOSFETs, tuner diodes, Monolithic Microwave Integrated Circuits, Small Scale Integrated Circuits and High Performance Actives and Passives on Chip (HiPACTM) as well as RF tuner ICs for digital and analog broadcasting systems. These products are mostly sold into the industrial, communications and consumer segments. At the same time we integrated our front-end manufacturing facility Power Logic, with locations in Regensburg and Munich, Germany, and Villach, Austria, into the Automotive & Industrial segment.

Automotive. The market for semiconductors for automotive applications has grown substantially in recent years, despite relatively slow growth in automobile production worldwide. This growth is the result of increased electronic content in automotive applications in the areas of safety, power train and body and convenience systems. This growth also reflects increasing substitution of mechanical devices such as relays with semiconductors in order to meet more demanding reliability, space, weight and power-reduction requirements. This trend has been particularly pronounced in the area of power ICs that deliver additional short circuit protection and other features.

Power train applications, such as transmission, engine and exhaust control, comprise the largest portion of the market, followed by safety and vehicle-dynamics systems, body and convenience systems, driver information and in-car entertainment.

We supply a wide range of semiconductor and complete chipset solutions for applications in the automotive industry. These products include power semiconductors, microcontrollers, discrete semiconductors and silicon sensors, along with related technologies and packaging. Our TriCore™ 32-bit microcontroller product portfolio, which is the latest microcontroller generation for applications such as powertrain or safety applications, has had significant design wins at several major customers. Within the sensor area, we complemented our product portfolio with the acquisition of SensoNor in 2003, giving us immediate access to the market for tire pressure monitoring systems. This market is expected to grow due to new legal requirements in the United States which are most likely due to take effect from the 2006 financial year.

Time periods between design and sale of our automotive products are relatively prolonged (two to four years) because of the long periods required for the development of new automotive platforms, many of which may be in different stages of development at any time. This is one of the reasons why automotive products tend to have relatively long life-cycles compared to our other products. The nature of this market, together with the need to meet demanding quality and reliability requirements designed to ensure safe automobile operation, makes it relatively difficult for new suppliers to enter the automotive market.

Our principal automotive products include:

- Semiconductors for power train applications, which perform functions such as engine and transmission control;
- Semiconductors for safety management, which manage tasks such as the operations of airbags, anti-lock braking systems, electronic stability systems and power steering systems;
- Semiconductors for body and convenience systems, which include light modules, heating, ventilation and air conditioning systems, door modules (power windows, door locks, mirror control) and electrical power distribution systems; and
- Semiconductors for infotainment, such as those used for wireless communication and navigation/telematics.

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We seek to exploit our strong relationship with, and proximity to, leading German and American car manufacturers and their suppliers, which have historically been at the forefront in using electronic components in cars, to strengthen our position in all segments of automotive electronics. We also seek to further strengthen our presence in the United States and to expand in other geographic areas, notably Japan. We believe that our ability to offer complete semiconductor solutions integrating power, analog and mixed-signal ICs and sensor technology is an important differentiating factor in the automotive market. We also believe that our strength in this relatively stable market complements our strengths in other markets that are subject to greater market volatility.

Industrial. The market for semiconductors for industrial applications is highly fragmented in terms of both suppliers and customers. It is characterized by a large number of both standardized and application-specific products. These products are employed in a large number of diverse applications in many industries such as factory automation, power supply and consumer products.

We supply a broad range of semiconductor products for use in industrial automation and control systems. These products comprise power modules, discrete semiconductors and microcontrollers.

Our industrial products are used in a wide range of applications, such as:

- Power supplies, divided into two main categories: uninterruptible power supplies, such as power backbones for Internet servers; and switched-mode power supplies for PCs, as well as battery chargers for mobile phones, notebook computers and other handheld devices;
- Drives for machine tools, motor controls, pumps, fans and heating, ventilation, consumer products (for example, TVs and DVD players), air-conditioning systems and transportation;
- Industrial automation, meters and sensors; and
- Other industrial applications such as power distribution systems and medical equipment.

Within the industrial segment, we focus on two major application segments, power management & supply and power conversion. We provide differentiated products combining diverse technologies to meet our customers specific needs. We have identified applications for household products (so called white goods) as an area of future growth.

Memory Products

Our Memory Products segment designs, develops, manufactures and markets semiconductor memory products with various packaging and configuration options and performance characteristics for use in standard, specialty and embedded memory applications. We were the third largest producer of DRAM in terms of revenues in the 2003 calendar year, with a worldwide market share of approximately 16 percent, according to iSuppli, compared to a 13 percent market share in the 2002 calendar year.

The global market for DRAM has experienced strong cyclicality in the past and is expected to continue to show this behavior in the future. Price and therefore revenue volatility depends on the relation between supply and demand, leading to strong declines in times of oversupply and relative stability or even increases in times of shortage. Visibility for both supply and demand is restricted and therefore market development is difficult to predict. The table below presents revenue and bit data as well as year-over-year price-per-bit development for the DRAM market since 1994 (Source: WSTS).

Calendar year	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
DRAM market in billion US$	23	41	25	20	14	21	29	11	15	17
DRAM market in billion megabits	8	13	23	46	87	163	258	420	590	823
Year over year change average price per bit .	-3%	1%	-66%	-60%	63%	-21%	-12%	-76%	-3%	-22%

The substantial price decline in the 2001 calendar year, which resulted from worldwide oversupply due to strongly increased capacity combined with reduced demand, especially in the PC segment, resulted in a substantial reduction in revenues from this business. In the 2002 calendar year prices for our DRAM products stabilized due to increased demand and consolidation within the industry as a consequence of the low price level in the second half of 2001. In the 2003 calendar year prices dropped again due to slow demand development. Prices for commodity DRAM products in

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U.S. dollars were relatively stable in the first three quarters of the 2004 calendar year due to healthy demand growth from the PC segment and due to only limited supply growth resulting from the low capital expenditure levels during the downturn and shifts of capacity away from DRAM to other memory or logic products throughout the DRAM industry. The memory market is characterized by a high rate of technological changes, with successive generations of products succeeding each other with high frequency. This rate of change is expected to continue in the future.

The highest share of volume of DRAM products is sold to the personal computer segment, which includes desktop and notebook computers, followed by workstations and servers. Markets for the latter products are expected to grow substantially in the next few years, whereas the market for personal computers is expected to decline as a proportion of the total market. Networking and handheld applications, even though currently representing only a small portion of DRAM demand, are expected to show strong growth rates in the coming years. Other applications for memory products include communications devices, computer peripherals, consumer products and graphics applications.

Our principal memory products are commodity DRAM components with densities from 128-Mbit to 1-Gbit and SDRAM, DDR and DDR2 interfaces. Based on these components we also manufacture standard desktop and notebook modules as well as high-density workstation and server modules. We also manufacture specialty DRAM products with high performance for graphics cards, and others with low power consumption for mobile applications, as well as embedded DRAM products. Beginning in calendar year 2004, we extended our product portfolio with a 512-Mbit NAND-compatible flash chip, for use in SD-Cards or as a component in TSOP packages. 256-Mbit DRAMs formed the largest part of our memory products sales in the 2004 financial year. We expect that in the 2005 financial year our leading product will be 512-Mbit DRAMs. We believe that offering high-end products, such as 1-Gbit DRAMs, highly integrated modules and specialty DRAMs, as well as having the ability to shift between DRAM and flash memories, depending on market conditions, can offer opportunities to mitigate some of the negative effects of the cyclicality of the memory products market.

Most of our DRAM products, commodities as well as specialties, are manufactured using our state-of-the-art 110-nanometer DRAM technology. We have substantially completed the conversion to this technology of the manufacturing capacity used for DRAM production. In particular, all DDR2 products 256-Mbit, 512-Mbit and 1-Gbit are manufactured using this technology.

Regarding application specific specialty DRAM products, we offer products with low power features, such as Mobile-RAM and CellularRam, and other specialty DRAM products with high performance with respect to bandwidth and access times, such as Reduced Latency DRAM and Graphics RAM:

- Mobile-RAM is a low-power SDRAM mounted in a small chip-size package and is dedicated to the markets for smart phones, Personal Digital Assistants (PDAs) and palm-size computers. Our 128-Mbit, 256-Mbit and 512-Mbit Mobile-RAM ICs are currently in volume production.

- Reduced Latency DRAM (RLDRAM) is used for networking applications in high-end servers and routers. This type of DRAM offers high bandwidth and fast random SRAM-like data access. Demand projections from customers for this product type have been largely reduced over the last 12 months. We have therefore decided to suspend the development of future RLDRAM generations. Nevertheless, we are committed to fulfilling our contracts and obligations in this area.

- CellularRAM is a low-power pseudostatic RAM targeted at high data rate 2.5G and 3G cellular phones. It is also pin compatible to SRAM solutions, thus providing SRAM performance with the higher densities of DRAMs. We have partnered with Micron as well as with Cypress Semiconductor Corp. to define product specifications, and started to ship the CellularRAM ICs to customers in 2004.

We are also engaged in the development of new generations of standard DRAM products for future IT infrastructure applications, and we are participating in the development of future DRAM interface architectures such as DDR3 and beyond.

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In addition to standard DRAM technology, we also sell system-on-chip products with embedded DRAM. These products eliminate the need for chip-to-chip interfaces and are particularly well-suited for applications where component space saving, power saving and higher bandwidth are important, such as the graphics for notebook and personal computers, personal digital assistants and mobile devices.

In April 2001, we established a joint venture (then called Ingentix) in which we held a 51 percent ownership interest with Saifun Semiconductors Ltd. In the 2003 financial year, we increased our ownership interest to 70 percent by contributing additional capital and converting existing shareholder loans to equity. The joint venture is operated through two companies, Infineon Technologies Flash GmbH & Co. KG, located in Dresden, Germany, and Infineon Technologies Flash Ltd., located in Netanya, Israel. The Israeli company is primarily responsible for product development, while the Dresden company conducts technology development, marketing and manufacturing operations. Our joint venture is developing NAND and NOR flash products based on Saifun s proprietary NROM flash technology, and introduced its first NAND products early in the 2004 financial year.

The reduction of chip sizes through the introduction of leading edge process technologies is one of the key factors in reducing manufacturing costs. By the end of the 2004 financial year, we had substantially completed the conversion of our DRAM capacity to technologies with a feature size of 110-nanometer. We have also achieved the first fully functional components and modules based on our next-generation 90-nanometer DRAM technology. By increasing volume production of 256-Mbit and 512-Mbit DDR and DDR2 using our advanced 110-nanometer process technology in the 2004 financial year, we further reduced our per-unit manufacturing cost. To further reduce per-unit manufacturing costs, we plan to start the ramp-up of our newly developed 90-nanometer process technology during the 2005 financial year. In addition, we are already developing a 70-nanometer process technology that we believe will allow us to further reduce per-unit costs in the future.

We have invested heavily throughout the DRAM market cycle, including during recent downturns, to maintain and build upon our leadership in DRAM products and high-end process technology. We aim to continue to be a worldwide leader in DRAM process technology. Due to our belief in the positive long-term growth prospects of the memory business, we have implemented our 300-millimeter plans and had ramped up our new Dresden production facility to 35,000 wafer starts per month by the end of our 2004 financial year. It was one of the first production facilities of its kind worldwide to manufacture semiconductors on a production scale using 300-millimeter technology, and has enabled us to significantly reduce our per-unit production costs. Due to unfavorable market conditions in the last three years, we had delayed equipping our Richmond manufacturing facility with 300-millimeter technology, but have now recommenced this effort, expecting to start production in the second half of the 2005 calendar year. The speed of the ramp-up and final capacity are subject to market conditions.

Going forward, we intend to follow a strategy of limiting our investment in manufacturing assets principally to upgrading existing manufacturing lines and increasing our capacity mainly through cooperating with partners, for example by forming joint ventures or by utilizing foundries. Such partnerships have included the following:

- In November 2002, we entered into agreements with Nanya, a Taiwanese DRAM manufacturer, for the joint development of 90-nanometer and 70-nanometer DRAM technologies as well as the construction of a jointly owned 300-millimeter DRAM manufacturing facility in Taiwan. The first results of this development alliance are fully functional components and modules based on the developed 90-nanometer technology as well as the first product demonstrators in 70-nanometer. Inotera, the manufacturing joint-venture with Nanya in Taiwan, completed construction of its 300-millimeter manufacturing facility and started mass production in the 2004 financial year.

- In addition, we signed a product purchase and capacity agreement with the Taiwan-based DRAM manufacturer Winbond, under which we license our 110-nanometer DRAM technology to Winbond in exchange for output of commodity DRAMs manufactured by Winbond using that technology. This agreement has been extended to include the licensing of our 90-nanometer technology and the transfer of our 300-millimeter know-how in

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exchange for additional 300 millimeter capacities from Winbond s newly planned manufacturing facility in Taiwan. In addition, Winbond and Infineon have agreed to cooperate in the future development of specialty DRAM products for low power applications.

- We also entered into a Know-How Transfer Agreement and a Product Purchase and Capacity Reservation Agreement with SMIC in China, which gives us access to additional DRAM production capacity based on 200-millimeter and 300-millimeter wafers and our 140-and 110-nanometer technology.

- We established a venture with China Singapore Suzhou Industrial Park Venture Co. Ltd., Suzhou, China, and have constructed a backend facility for the assembly and testing of memory ICs.

See Business Manufacturing Manufacturing ventures and partnerships for a description of our manufacturing arrangements with strategic partners.

Although the market for DRAM has experienced more or less severe price erosion in recent financial years, we expect to benefit from any potential future increases in demand for DRAMs resulting from increased demand for servers and for personal computers with Internet access. We also believe that our leading role in high-end and high-performance DRAM products provides us with opportunities in the market for workstations, servers and mobile applications. We believe that, by broadening our product portfolio within and beyond DRAM, for example with flash memory, we will be able to reduce the volatility of our memory business and strengthen relationships with our customers.

Customers, Sales and Marketing

Customers

We sell our products to customers located in Germany, the rest of Europe, the United States, and the Asia/Pacific region and Japan. We target our sales and marketing efforts in the field of demand creation at approximately 400 direct customers worldwide (including distributor and Electronic Manufacturing Services (EMS) accounts). Of these direct customers, 8 are currently deemed corporate accounts and up to an additional 30 are deemed major customers. The Siemens group was the only customer that accounted for 10% or more of our net sales in the 2004 financial year.

We focus our sales efforts on semiconductors customized to meet our customers needs. We therefore seek to design our products and solutions in cooperation with our customers so as to become their preferred supplier. We also seek to create relationships with our major customers that are leading in their market segment and have the most demanding technological requirements in order to obtain the system expertise necessary to compete in the semiconductor markets.

We have sales offices throughout the world. We believe that this global presence enables us not only to respond promptly to our customers needs, but also to be involved in our customers product development processes and thereby be in a better position to design customized ICs and solutions for their new products. We believe that cooperation with customers that are leaders in their respective fields provides us with a special insight into these customers concerns and future development of the market. Contacts to our customers customers and market studies about the end consumer also position us to be an effective partner.

We believe that a key element of our success is our ability to offer a broad portfolio of technological capabilities and competitive services to support our customers in providing innovative and competitive products to their customers and markets. This ability permits us to balance variations in demand in different markets and, in our view, is a significant factor in differentiating us from many of our competitors.

Below we provide more detailed information on the customers of each of our principal segments:

Wireline Communications. The Wireline Communications segment sells IC products for telecommunication and data communication applications to a world-wide customer base, targeted at system providers of a new generation of broadband communication applications. In the 2004 financial year, the Siemens group was this segment s largest OEM customer. Our leading telecommunications

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and data communications customers include Avnet and Flextronics who are our distributors and system manufacturers for Alcatel, Ericsson Huwaei and Nortel.

In the 2003 calendar year, the communications market showed an increased demand for broadband solutions. We maintained our number two position in the overall access market by increasing our share in traditional telecom sector (E/T carrier, analog line cards) and the ramp up of our broadband ADSL business. The Wireline Communications segment focused sales and marketing efforts on the rollout of complementary end-to-end system solutions enabling IP communication all the way from the metro ring to the customer premises.

The Wireline Communications segment maintains its leading position in Europe while increasing its marketing and sales efforts in the Asia/Pacific and Japan markets which have turned out to be the worldwide potential for our broadband communication solutions.

Secure Mobile Solutions. Customers for cellular telephone applications purchase products that range from our own complete system IC kits, to customized ASSPs that we produce to customer design and specifications, to complete system solutions. Customers for cordless telephone or Bluetooth applications typically purchase complete system IC kits. We supply the major share of the baseband ICs needs of Siemens. To our wireless infrastructure customers, such as Ericsson we supply RF-ICs, synthesizers and RF-power products. Nokia purchases our radio-frequency ASICs.

The Security business derives a large portion of its revenues from large scale projects. Four key accounts Axalto, Gemplus, Giesecke & Devrient and Oberthur Card Systems accounted for a large share of the segment s sales. The customers are mainly card manufacturers, acting both on their own account and as directed by their own service provider customers.

We maintained our strong position in Europe and Asia/Pacific and have increasingly focused on China for both cellular and security business.

Automotive & Industrial. In the automotive business, which includes sales of microcontrollers, power devices and sensors, our customer base includes most of the world s major automotive suppliers. Two major customers, Bosch and the Siemens group, together accounted for approximately one-quarter of the segment s net sales in the 2004 financial year. Bosch purchases products mainly for automotive applications. The Siemens group purchases semiconductors for automotive and industrial applications. Sales of automotive products are made primarily in Europe and, to an increasing extent, the United States.

In the industrial business, the Siemens group is the single largest customer, but the bulk of the industrial segment s sales are made in small volumes to customers that are either served directly or through third-party distributors. Our sales of industrial products vary by type of product, with devices for drive and power conversion applications sold primarily in Europe and the United States, and devices for power management and supply sold primarily in Asia (other than Japan) and Europe.

Memory Products. The Memory Products segment sells memory devices, primarily DRAMs, in the United States, Europe, the Asia/Pacific region and Japan. We focus our marketing efforts for memory products on a number of manufacturers of personal computers and servers that are growing faster than others, that provide stable demand and that we believe to be good partners for product development. Increasingly the segment sells its specialty DRAM products to providers of consumer and communication applications. In the 2004 financial year, our major customers included the leading PC and server manufacturers worldwide, such as Dell, HP and IBM, as well as module manufacturers, such as Kingston and Solectron.

The segment s major customers are served on a global basis, with sales efforts and deliveries in all regions where the customer has operations. For each of these major customers, the segment seeks to be among its top three suppliers of DRAMs in terms of service, quality and volume. The segment also sells commodity and specialty DRAM products to a number of smaller customers.

Sales and Marketing

We create and fulfill the majority of our net sales directly, though we increasingly make sales through our global network of distributors and partners in the Electronic Manufacturing Services (EMS) segment. A very small and decreasing portion of sales are still made through the Siemens group sales organizations.

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The responsibility for all direct accounts as well as the management of our indirect sales channels lies within our global sales organization. To better serve our customers, our Account Managers develop, maintain, manage and coordinate all aspects of our relationship and activities with each major customer. Eleven Corporate Account Executives are responsible for the global relationships with our most important strategic customers. The relationships with all other customers that are active on a worldwide basis are overseen by dedicated Account Managers. Our regional sales units service global accounts based in that region, as well as regional accounts that are the key players in their local markets. In 4 smaller markets, Poland, South Africa, Spain and Turkey we currently still use the Siemens group sales organizations to sell our products.

Within the indirect sales channel, our sales organization manages relations with our third party sales representatives, which are located primarily in the United States. In addition, we increasingly cover indirect accounts through our worldwide network of independent distributors, with whom we have regional or global distribution agreements. This distribution network is managed by our worldwide Sales Distribution organization, which coordinates all aspects of distribution channel management and increases our market activities in the broad market.

Many of our traditional customers rely increasingly on EMS providers to manufacture their products, which many of our customers in newer industries have always outsourced their production. We have responded to this market trend by establishing an internal EMS sales organization that focuses on the market leaders in the EMS industry. Our EMS global account managers and dedicated support personnel ensure high service level and facilitate smooth transfers of manufacturing from OEM (Original Equipment Manufacturer) to EMS. The EMS sales organization is also charged with securing a significant share of the standard product purchase of these customers, largest users in the industry, and with concluding strategic partnerships for design and technology projects. Especially in the wireless communications market, we increasingly deal with Original Design Manufacturers (ODMs) that design and manufacture complete systems for OEMs. We support the ODMs in the development of board design and software, by providing them with additional assistance using our own resources and/or resources of our partner network.

As of September 30, 2004, we had approximately 1,950 sales and marketing employees worldwide. To support our sales efforts, strengthen the relationship with our customers and improve our service levels, we utilize internet-based systems solutions. These enable us to reduce our response time to existing customers and to market inquiries.

We utilize advertising campaigns in the general and trade press to establish and strengthen our identity as a major semiconductor provider. We participate actively in trade shows, conferences and events to strengthen our brand recognition and industry presence.

Backlog

Standard Products. Cyclical industry conditions in the Memory Products market, in particular make it undesirable for many customers to enter into long-term, fixed-price contracts to purchase standard (i.e., non-customized) semiconductor products. As a result, the market prices of our standard semiconductor products, and our revenues from sales of those products, fluctuate very significantly. Most of our standard non-memory products are priced, and orders are accepted, with an understanding that the price and other contract terms may be adjusted to reflect market conditions at the delivery date. It is common industry practice to permit major customers to change the date on which products are delivered or to cancel existing orders. For these reasons, we believe that the backlog at any time of standard products such as memory products is not a reliable indicator of future sales.

Non-standard Products. Logic products are more customized than memory products. Therefore, orders are generally made and prices are determined well in advance of delivery. Quantities and prices of logic products may nevertheless change between the times they are ordered and when they are delivered, reflecting changes in customer needs and industry conditions. During periods of industry overcapacity and falling sales prices, customer orders are generally not made as far in advance of the scheduled shipment date as during periods of capacity constraints, and more customers request logistics agreements based on rolling forecasts. The resulting lower levels of backlog reduce our management s ability to forecast optimum production levels and future revenues. As a result, we do not rely solely on backlog to manage our business and do not use it to evaluate performance.

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At the end of the 2004 financial year our backlog remained at approximately the same level as at the start of the year. Due to possible changes in customer delivery schedules, cancellation of orders and potential delays in product shipments, our backlog as of any particular date may not be indicative of actual sales for any later period.

Competition

The markets for many of our products are intensely competitive. We face significant competition in each of our product lines. We compete with other major international semiconductor companies, some of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing and distribution of their products. Smaller niche companies are also increasing their participation in the semiconductor market, and semiconductor foundry companies have expanded significantly. Competitors include manufacturers of standard semiconductors, application-specific ICs and fully customized ICs, including both chip and board-level products, as well as customers that develop their own integrated circuit products and foundry operations. We also cooperate in some areas with companies that are our competitors in other areas.

The following table shows key competitors for each of our segments in alphabetical order:

Key Competitors By Segment

Wireline Communications	Broadcom, Conexant, Legerity, ST Microelectronics and Texas Instruments
Secure Mobile Solutions	Freescale, Philips, Qualcomm, ST Microeletronics and Texas Instruments
Automotive & Industrial	Fairchild, Freescale, International Rectifier, Mitsubishi and ST Microelectronics
Memory Products	ELPIDA, Hynix, Micron, Powerchip and Samsung

Competition among semiconductor suppliers has intensified in recent years. Memory products, particularly DRAM ICs, have seen the fiercest competition, but we expect that competition among suppliers of ICs used for logic products will become at least as intense, if not more so, in the next few years.

We compete in different product lines to various degrees on the basis of product design, technical performance, price, production capacity, product features, product system compatibility, delivery times, quality and level of support. Innovation and quality are competitive factors for all segments. Production capacity and delivery reliability play a particularly important role in the Memory Products segment, where customers demand delivery within a very short period of time, and in the Automotive & Industrial segment.

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

- successful and timely development of new products, services and manufacturing processes;
- product performance and quality;
- manufacturing costs, yields and product availability;
- pricing;
- our ability to meet changes in our customers demands by altering production at our facilities;
- our ability to provide solutions that are responsive to our customer needs;
- the breadth and capability of our service offering; and
- the competence and agility of our sales, technical support and marketing organization.

Entry into semiconductor manufacturing, particularly DRAM manufacturing, requires substantial capital expenditures and significant technological and manufacturing expertise. We believe this

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provides us with a significant time-to-market advantage over any potential new entrant in the DRAM market.

Manufacturing

Our production of semiconductors is generally divided into two steps, referred to as the front-end process and the back-end process.

Front-end. In the first step, the front-end process, electronic circuits are produced on silicon wafers, which we buy from outside sources. The front-end production process involves a series of patterning, etching, deposition and implantation processes. At the end of the front-end process, we test the chips for functionality.

We believe that we are one of the leaders in the semiconductor industry in terms of the structure size on our wafers. Structure size refers to the minimum distances between electronic structures on a chip. Smaller structure sizes increase production efficiencies in the manufacture of memory and logic products. The structure size of our current logic products is as small as 130-nanometers using copper wiring. The structure size of our current memory products is as small as 110-nanometers and we are preparing to ramp up production of memory products of 90-nanometers.

High-end mask technology is a prerequisite for achieving small structure size. A mask is a master image of a circuit pattern used to produce ICs. We manufactured high-end masks at our Munich Balanstrasse facility which was closed as planned by the end of September 2004. In May 2002 we established the Advanced Mask Technology Center, a joint venture with AMD and DuPont Photomasks located in Dresden, to develop leading-edge photo masks. At the same location, DuPont Photomasks is setting up a mask foundry for high-end photomasks. Both plants became operational during the first half of the 2004 calendar year and replaced the Munich facility as our mask provider. DuPont Photomasks also supplies us with masks under a long-term mask supply agreement.

In the 2004 financial year, we further increased the share of DRAM manufacturing on 300-millimeter diameter wafers. Our Dresden facility currently has achieved full production qualification on 300-millimeter wafers, using 110-nanometer technology. Our joint venture with Nanya, Inotera, started ramp-up of its 300-millimeter capacity in the first half of calendar year 2004 and the 300-millimeter facility of our foundry partner SMIC in Beijing was officially opened in September 2004. At September 30, 2004, we had substantially completed the conversion of our memory capacity to 110-nanometer technology. The increasing share of 300-millimeter production and 110-nanometer technology should substantially reduce our overall per-unit cost for memory chips.

Back-end. In the second step of our semiconductor production, the back-end process (also known as the packaging, assembly and test phase), the processed wafers are ground and mounted on a synthetic foil, which is fixed in a wafer frame. Mounted on this foil, the wafer is diced into small silicon chips, each one containing a complete integrated circuit. A pick and place machine removes individual chips from the foil and glues them onto lead-frames, which hold the future pins of the product. The next step is creating electrical links between the chip and the pins, called bonding. Then all the process steps inside the package are finished and the chips are molded with compounds. Depending on the package type, the molded chips undergo a punching and pin bending process. At the end, the semiconductor undergoes final functional tests.

We believe that our back-end facilities are equipped with the latest technology, enabling us to perform assembly and test on a cost-effective basis. These facilities also provide us with the flexibility needed to customize products according to individual customer specifications. We believe that our back-end facilities provide an important competitive advantage, especially with respect to IC testing and discrete devices.

We had no significant unplanned production stoppages during the 2004 financial year.

Facilities

We operate manufacturing facilities around the world, including joint ventures in which we participate. The following table shows selected key information with respect to our current major manufacturing facilities:

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Current Manufacturing Facilities

	Year of commencement of first production line	Principal products or functions
Front end facilities: wafer fabrication plants		
Dresden, Germany	1996	DRAM, ASICs with embedded Flash memory, logic ICs
Essonnes, France[1]	1963[2]	Logic ICs and ASICs with embedded Flash memory
Munich Perlach, Germany	1987	High frequency; sensors
Regensburg, Germany	1986	Non volatile memory, power and logic ICs; High Frequency ICs
Richmond, Virginia	1998	DRAM
Taoyuan, Taiwan[3]	2004	DRAM
Villach, Austria	1979	Power, smart power and discretes
Warstein, Germany	1965[2]	High power
Back-end facilities: assembly and final testing plants		
Batam, Indonesia	1996	Assembly & test for more mature lines of logic ICs, Power ICs
Berlin, Germany	1986	Fiber optic components and modules
Cegled, Hungary	1997	High power
Dresden, Germany	1996	DRAM components and modules
Malacca, Malaysia	1973	DRAM components and modules, discretes and power packages, logic ICs
Morgan Hill, California	2002	RF-power
Porto, Portugal	1997	DRAM components and modules
Regensburg, Germany	2000	Chip card modules Fiber optic modules, sensors and pilot lines
Richmond, Virginia	1998	DRAM components and modules
Singapore	1970	Assembly leadless logic ICs, final test logic IC
Suzhou, China[4]	2004	DRAM components and modules
Trutnov, Czech Republic	1994	Fiber optic components and modules
Warstein, Germany	1965[2]	High power
Wuxi, China	1996	Discretes, chip card modules

(1) ALTIS Semiconductor, our joint venture with IBM in which we own 50 percent plus one share. Our share in the production of the joint venture is currently 50 percent. We have agreed with IBM to increase our share of the production ratably from 2004 through 2007 to 100 percent.
(2) The current main production line began operations in 1991.
(3) Inotera Memories, our joint venture with Nanya.
(4) Infineon Technologies Suzhou, our joint venture with CSVC.

Our front-end facilities currently have a capacity of approximately 80,000 wafer starts per week (in 8-inch equivalents). We have the ability to meet additional demand for logic ICs by shifting production from memory products and expanding our utilization of silicon foundries.

We have devoted substantial resources to reducing our production costs over the past several years and believe that costs at our Dresden and Richmond DRAM manufacturing facilities are currently comparable with those of our lowest-cost competitors.

Generally, we use foundries to assist us in meeting demand for increased chip volumes. In recent years, we have enhanced our manufacturing cooperation with UMC, particularly with respect to front-end production of EEPROM, Flash technology for our chip card IC products, and CMOS baseband products for wireless communications. Currently we are introducing the jointly developed 90-nanometer technology node. We have entered into a joint development agreement with IBM,

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Chartered Semiconductor Manufacturing Ltd. (Chartered) and Samsung Electronics Co. Ltd. (Samsung), to accelerate the move to 65-nanometer process technology.

In 1998, we introduced our memory fab cluster concept. It consists of our world class wafer fabrication facilities in Dresden and Richmond and corresponding back-end sites in Dresden, Richmond, Malacca and Porto, as well as our backend subcontractors EEMS Italia SpA and Kingston Technology Company Inc. The fab cluster concept allows us to use best processes to maximize quality and enables us to ship memory products from multiple sites. We can therefore supply memory products to anywhere in the world from any of the fabrication facilities in our fab cluster. We believe that the fab cluster reduces our exposure to delivery problems. Also, by locating our facilities in different areas, we can recruit talent globally.

We have extended the fab cluster concept to include fabrication sites of our Taiwanese partners Winbond and Inotera, as well as our Chinese partner SMIC.

Manufacturing ventures and partnerships

As part of our strategic alliances we have established the ALTIS joint venture with IBM, and the Inotera joint venture with Nanya. For further information on these ventures and our alliances with IBM and Nanya, see Strategic Alliances below. In addition, we have established the following manufacturing ventures and arrangements with partners:

AMTC. In May 2002, we entered into agreements with AMD and Du Pont Photomask to establish our strategic cooperation in the field of advanced lithographic photomasks. Under the terms of these agreements, we will co-develop photomasks and share development costs. For this purpose the three partners have established an equally owned joined venture called Advanced Mask Technology Center GmbH & Co. KG in Dresden, Germany, to construct and operate a photomask manufacturing facility (mask center). The mask center will develop and produce lithographic masks and samples. The mask center started operations in the 2004 calendar year.

CSVC. We have established a venture with China Singapore Suzhou Industrial Park Venture Co. Ltd. (CSVC), Suzhou, China, and constructed a backend facility for the assembly and testing of memory ICs. The facility is located in the Suzhou Industrial Park, near Shanghai and was officially opened in September 2004. It will have an output capacity of up to one billion chips per year, and will be developed in a number of stages as dictated by growth and trends in the global semiconductor market. In the 2004 financial year we invested U.S. $46 million in the venture and plan to invest additional U.S. $196 million through 2008. It is anticipated that any further investment required to purchase additional equipment would be financed externally by the joint venture.

SMIC. In December 2002, we entered into a Know-How Transfer Agreement and a Product Purchase and Capacity Reservation Agreement with SMIC which gives us access to additional DRAM production capacity. Under the terms of these agreements, we have transferred our 140-nanometer DRAM-trench technology to SMIC. In return, SMIC is manufacturing and we are purchasing up to 20,000 wafers per month out of SMIC s 200-millimeter production facility in Shanghai. We revised our agreement with SMIC during the 2004 financial year to include next generation technology.

In March 2003, we entered into extended Know-How Transfer and Product Purchase and Capacity Reservation Agreements with SMIC, which give us access to additional DRAM production capacity in SMIC s 300-millimeter facility in Beijing, which was officially opened in September 2004. Under the terms of these agreements, we will transfer our 110-nanometer DRAM-trench technology and some 300-millimeter manufacturing know-how to SMIC. In return, SMIC will manufacture and we will purchase up to 15,000 wafers per month out of SMIC s facility.

Winbond. In May 2002, we entered into a Know-How Transfer and License Agreement and a Product Purchase and Capacity Reservation Agreement with Winbond, which give us access to additional DRAM production capacity. Under the terms of these agreements, we transfer and license our 110-nanometer DRAM trench technology to Winbond. In return Winbond manufactures and we purchase up to 20,000 wafers per month out of Winbond s 200-millimeter production facility in Hsinchu (Taiwan). The agreements further allow Winbond to use the Know-how for the production of its proprietary specialty DRAMs.

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In August 2004, we entered into an extended Know-How Transfer and License Agreement and an extended Product Purchase and Capacity Reservation Agreement with Winbond, which gives us access to additional DRAM production capacity in Winbond s planned 300-millimeter facility in Taiwan. Under the terms of these agreements, we will transfer our 90-nanometer DRAM-trench technology and some 300-millimeter manufacturing know-how to Winbond. In return, Winbond will manufacture DRAMs for computing applications in this technology exclusively for Infineon. Furthermore, Infineon and Winbond intend to jointly develop specialty memories for mobile applications.

Research and Development

Research and development (R&D) is critical to our continuing success. Although we scaled back our planned R&D spending during the market downturn in our 2001 and 2002 financial years, we are committed to maintaining high levels of R&D expenditures over the long term. The table below sets forth information with respect to our research and development expenditures for the periods shown:

Research and Development Expenditures

	Financial year ended September 30,		
	2002	2003	2004
Expenditures in millions (net of subsidies received)	€ 1,060	€ 1,089	€ 1,219
As a percent of net sales	22%	18%	17%

Most of our R&D activities are concentrated in the following areas: product development, process technology, reusable cores and modules, computer aided design and libraries, packaging technology and basic research.

Our logic ICs utilize complex system-on-chip designs and require a wide variety of intellectual property and sophisticated design methodologies, for example to combine high performance with low power consumption. We believe that our emphasis on intellectual property and methodologies for logic ICs and their protection through patents will enable us to strengthen our position in the logic IC market and that our expertise in mixed signal devices is a particular competitive strength.

Process technologies have been another important focus for our R&D activities, as we have sought to reduce structure sizes and develop new processes. We have successfully ramped up our high-performance process technology using structure sizes of 130-nanometer for logic products, allowing for up to eight layers of copper metallization. We are in the phase of introducing a 90-nanometer process and have a technology roadmap for the next several years encompassing structure sizes down to 32-nanometer. Our process technologies benefit from many modular characteristics, including special low-power variants, analog options and high-voltage capabilities. For memory process technology we successfully ramped up our 110-nanometer process technology for DRAM products during the 2004 financial year. A strategic development alliance with Nanya Technology for trench based DRAM technology allows us to share development costs and resources. The development alliance is currently developing 90-nanometer and 70-nanometer process technology for DRAM products.

In recent years we have devoted substantial resources to improving our R&D processes. In particular, we have improved our computer aided design (CAD) systems and our libraries. CAD systems are a crucial tool for our product designers. Libraries are databases that contain templates and standard design elements that are common to multiple products. We believe that our efforts in these areas enable us to reduce development cycle times and optimize our designs with regard to higher performance and reduced power consumption.

We also incur R&D expenditures through the purchase of businesses that have R&D projects in process, but which have not yet reached the technological feasibility stage. In the 2004 financial year we incurred an in-process R&D charge of €9 million related to our acquisition of ADMtek.

R&D activities are mainly managed within each of our segments. A central development group conducts those R&D projects that are of strategic importance, where the results are used across all

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segments. Very advanced basic or theoretical research, for example in the field of nano-electronics, is conducted by our central research department

We maintain an extensive network of cooperation arrangements with industrial cooperation partners, technical institutes and universities to remain current with technological developments.

Research and development activities are conducted at locations throughout the world. The following table shows our major research and development locations and their respective areas of competence:

Principal Research and Development Locations

Location	Areas of Competence
Bangalore, India	Software development, library, design flow, SoC design implementation
Dresden, Germany	Flash and DRAM technology development
Düsseldorf, Germany	Mobile communications, radio frequency, product optimization
Graz, Austria	Contactless systems, Automotive power systems
Hanover, Germany	Mobile ICs
Kista, Sweden	Wireless systems
Munich, Germany	Main product development site; CAD, library, simulation technologies, layout synthesis, mixed signal, radio frequency, DRAM, 16 bit microcontrollers, ASICs with embedded DRAM, chip card ICs
Nuremberg, Germany	Software for wireless systems
Raleigh, North Carolina	Product development for commodity and specialty DRAM
Regensburg, Germany	Packaging, testing
Singapore	Software and System development for wireless products
Sophia Antipolis, France	Wireless baseband products, contactless products, digital signal processing, library, design flow
Taipeh, Taiwan	Wireline access design
Villach, Austria	Power semiconductor products, mixed signal for deep submicron, automotive and telecommunications applications
Xi an, China	SoC and DRAM design & product implementation, implementation of digital product designs in standard CMOS technology

At September 30, 2004 our research and development staff consisted of approximately 7,160 employees working in our R&D units throughout the world, a net increase of approximately 1,260 compared to 5,900 at September 30, 2003. This increase in R&D staff reflects new hires to support our solutions strategy and strengthen our position in Asia/Pacific, as well as the addition of R&D personnel of SensoNor and ADMtek, as well as the opening of a new R&D location in Xi an, China.

Intellectual Property

Our intellectual property rights include patents, copyrights, trade secrets, trademarks, utility models, designs and maskwork rights. The subjects of our patents primarily relate to IC designs and process technologies. We believe that our intellectual property is a valuable asset not only to protect our investment in technology but also a vital prerequisite for cross license agreements with third parties.

At September 30, 2004, we owned more than 41,000 patent applications and patents (both referred to as patents below) in countries throughout the world. These patents belong to

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approximately 11,400 patent families (each patent family containing all patents originating from the same invention). At September 30, 2004, approximately 91 percent of our patent families included patents registered in Europe, approximately 63 percent included patents registered in the United States and approximately 35 percent included patents registered in Asia. We filed first patent applications for approximately 1,700 inventions worldwide in the 2003 financial year. As of September 30, 2004, approximately 5,500 of our patent families included at least one patent granted in the United States or Europe.

In connection with our formation, the Siemens group transferred most of its semiconductor-related intellectual property to us. Further to our formation as a separate legal entity and in preparation for our initial public offering in March 2000, we entered into a patent cross license agreement with Siemens. As described below, certain of our rights and Siemens rights to utilize each others patents under the cross license agreement depend upon the date on which Siemens ceased to own or control more than 50 percent of our company s shares (referred to herein as the Control Date). Under the cross license agreement, among other things:

- Siemens granted us the right to use all of the more than 100,000 patents and related intellectual property rights that Siemens owns (the Siemens Patents). The agreement enables us to use these patent rights within the scope of our business, subject, in the case of information handling systems, to restrictions on our ability to use them in new spheres after the Control Date.

- Siemens granted us certain rights to sublicense the Siemens Patents within the scope of our business pursuant to cross license agreements entered into before the Control Date.

- We granted Siemens the right to use and sublicense within the scope of its business approximately 15 percent of the 20,000 patent rights that Siemens transferred to us upon the formation of our company (the Dual Use Patents).

- We granted Siemens the right to assert the Dual Use Patents insofar as they relate to the scope of its business activities. Siemens agreed, however, that it will not exercise this right of assertion against any of our customers in respect of any part of such customer s products that contains a product of ours, unless this right is asserted for defensive purposes.

- We agreed that we will not exercise our right to assert the Dual Use Patents against Siemens customers in respect of any part of such customer s products that contains a product of Siemens, unless this right is asserted for defensive purposes.

- Siemens and we agreed that any license to third parties of Dual Use Patents that could fall within the scope of either Siemens business or our business will be negotiated by the party first involved, acting with the consent of the other.

- We granted Siemens the right to use all of our patent and related intellectual property rights other than the Dual Use Patents (the Infineon Patents) within the scope of its business, subject, in the case of information handling systems, to restrictions on Siemens ability to use the Infineon Patents in new spheres after the Control Date.

- We granted Siemens certain rights to sublicense the Infineon Patents within the scope of its business pursuant to cross license agreements entered into before the Control Date.

- We and Siemens granted each other the above mentioned rights and licenses under each other s patents for which an application had been filed prior to the Control Date.

It is common industry practice for semiconductor companies to enter into patent cross license agreements with each other. These agreements enable each company to utilize the patents of the other on specified conditions. In some cases, these agreements provide for payments to be made by one party to the other. We are a party to a number of patent cross license agreements, including agreements with other major semiconductor companies. We believe that our own substantial patent portfolio enables us to enter into patent cross license agreements on favorable terms and conditions. We are currently in patent cross license negotiations with several major industry participants and expect to enter into additional patent cross license agreements in the future.

Our success depends in part on our ability to obtain patents, licenses and other intellectual property rights covering our products and their design and manufacturing processes. To that end, we

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have obtained many patents and patent licenses and intend to continue to seek patents on our developments. The process of seeking patent protection can be lengthy and expensive, and there can be no assurance that patents will be issued from currently pending or future applications or that, if patents are issued, they will be of sufficient scope or strength to provide us with meaningful protection or any commercial advantage. In addition, effective copyright and trade secret protection may be limited in some countries or even unavailable.

Many of our competitors also seek to protect their technology by obtaining patents and asserting other forms of intellectual property rights. Third party technology that is protected by patents and other intellectual property rights may be unavailable to us or available only on unfavorable terms and conditions. Third parties may also claim that our technology infringes their patents or other intellectual property rights, and they may bring suit against us to protect their intellectual property rights. From time to time, it may also be necessary for us to initiate legal action to enforce our own intellectual property rights. Litigation can be very expensive and can divert financial resources and management attention from other important uses. It is difficult or impossible to predict the outcome of most litigation matters, and an adverse outcome can result in significant financial costs that can have a material adverse effect on the losing party. We are currently engaged in several material disputes over intellectual property rights, including litigation with Rambus and MOSAID Technologies. For a description of these matters, see Legal Matters Litigation .

Strategic Alliances

Cooperation in product design, development and manufacturing between semiconductor suppliers and customers is increasing in response to the growing diversity and complexity of semiconductor products and applications, the demands of technological change and the costs associated with keeping pace with industry developments. Alliances with customers provide the manufacturer with valuable systems and applications know-how and access to markets for key products, while allowing the manufacturer s customers to share some of the risks and benefits of product development. Customers also gain access to the manufacturer s process technologies and manufacturing infrastructureAlliances with other semiconductor manufacturers permit costly research and development and manufacturing resources to be shared to mutual advantage for joint technology development.

As part of our strategy, we have entered into a number of long-term strategic alliances with leading industry participants for the manufacture of products and for research and development relating to the development of new products and manufacturing process technologies. These strategic alliances confer a number of important benefits, including:

- worldwide access to the expertise of other industry leaders in their respective areas, including manufacturing competence in new locations and additional experienced research and development employees;
- the sharing of risks inherent in the development and manufacture of new products;
- the sharing of costs, including production ramp-up costs and research and development costs; and
- efficiency gains, including reduced time to market of new generations of semiconductor devices and economies of scale.

Memory Products

In order to maintain our technological leadership in the DRAM market and to share start-up costs inherent in developing successive generations of memory products, we have entered into a number of strategic alliances with selected partners for research and development and manufacturing activities in relation to memory products.

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The following table shows our most important memory related strategic alliances, as well as their respective activities and locations:

Strategic alliances for memory products

Partner	Technology	Activity	Location
Nanya	90- and 70-nanometer DRAM process	R&D in both product and technology development, Manufacturing JV: Inotera	Dresden and Munich, Germany/Taoyuan, Taiwan

Logic Products

In order to remain at the forefront of technological advancement and to share the initial costs inherent in bringing out successive generations of logic products, we have entered into a number of strategic alliances with selected partners for research and development and manufacturing activities in relation to logic products.

The following table shows our most important logic related strategic alliances, as well as their respective activities and locations:

Strategic alliances for logic products

Partner	Technology	Activity	Location
IBM	180-nanometer and 130-nanometer CMOS process	Technology development	East Fishkill, New York
IBM/UMC	90-nanometer CMOS process	Technology development	East Fishkill, New York
IBM/Chartered/ Samsung	65-nanometer CMOS process	R&D in both product and technology development	East Fishkill, New York
IBM	45-nanometer CMOS process and product ramp up	R&D in both product and technology development	East Fishkill, New York
UMC	90-nanometer CMOS process and product ramp up	R&D in both product and technology development	Hsinchu, Taiwan
UMC	130-nanometeEmbedded Flash	R&D in both product and technology development	Hsinchu, Taiwan

Principal Alliances

Our principal alliances are with IBM, UMC and Nanya:

IBM. In 1997, we entered into a joint development agreement with IBM to develop common process technologies for manufacturing logic products with minimum feature sizes of 180-nanometer and 130-nanometer. In 1999 we signed an agreement to continue this partnership for 90-nanometer technology, and included UMC in the alliance. In 2000 we entered into a joint development agreement with IBM to develop future generations of DRAM process technologies, down to feature sizes of 110-nanometer. In 2003 we agreed with IBM to jointly develop 65-nanometer and 45-nanometer logic technologies, and included Chartered Semiconductor in the alliance with respect to 65-nanometer technologies. Later, we, IBM and Chartered extended the agreements with respect to 65-nanometer logic technologies to include Samsung Electronics.

Our principal cooperation with IBM began in 1991, when we entered into an arrangement with IBM under which IBM manufactured DRAM products in its Essonnes facility and we received a share of the production. Based upon our history of cooperation with IBM, we agreed with IBM to convert the Essonnes facility to production of logic devices and to convert the existing production

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cooperation arrangement into a joint venture called ALTIS Semiconductor. We own 50 percent of the joint venture s shares plus one share and IBM owns the rest. Both our company and IBM have one vote at the joint venture s shareholders meeting, and we are both entitled to nominate one of the joint venture s two chairmen. The joint venture became effective on July 12, 1999, and the facility s conversion to logic production has been completed. Both companies have agreed to have only one jointly appointed CEO.

The joint venture agreements impose certain restrictions on the ability of each of the shareholders to sell or transfer its shares in the joint venture, and also provide that each shareholder may acquire the other s shares at an appraised value if the other shareholder undergoes a change of control. For this purpose, change of control means the acquisition by a third party of more than 35 percent of the outstanding equity of the other shareholder or any consolidation, merger or reorganization of the other shareholder in which it is not the surviving corporation. Each of Infineon and IBM may acquire the other s shares in the joint venture or dissolve the joint venture if there is a deadlock or if the other party defaults on its obligations under the joint venture agreement.

During the 2003 financial year, we and IBM amended the original shareholders agreement of ALTIS. Pursuant to the amendment, we will ratably increase our capacity reservation in the production output of ALTIS from the existing level of 50 percent to 100 percent during calendar years 2004 through 2007. We and IBM have agreed that we will decide the future business model of ALTIS not later than January 1, 2007. Additionally, we were granted an option through July 1, 2007 to acquire IBM s interest in ALTIS.

In 2003, we entered into a joint development agreement with ALTIS to jointly develop emerging non-volatile MRAM (Magnetoresistive Random Access Memory) technology.

UMC. In 1999, UMC, a leading semiconductor foundry, joined as an additional partner in our alliance with IBM for logic technology development.

In 2002, UMC decided to withdraw from this alliance. We decided that after the completion of our development of 90-nanomenter technology, we would ramp our first products using such technology, but would cease our future R&D cooperation. Our cooperation continues with respect to electrical and geometrical target parameters, in order to keep our process technology closely aligned. UMC continues to be the prime manufacturing foundry partner for our products.

In 2000, we entered into a joint development agreement with UMC to develop common process technologies for the manufacture of logic products with embedded flash memory capabilities based on a feature size of 130-nanometer.

Nanya. In November 2002, we entered into agreements with Nanya to establish our strategic cooperation in the field of standard DRAM memory products. Under the terms of these agreements, we are co-developing and share development costs for advanced 90-nanometer and 70-nanometer production technologies for 300-millimeter wafers. We have established the Inotera joint venture for the production of DRAM chips, and for the construction of a new jointly owned 300-millimeter manufacturing facility in Taiwan.

It is envisaged that, when completed, Inotera s 300-millimeter manufacturing facility will employ the production technology developed under our joint development agreement with Nanya. The facility s capacity is expected to be completed in two phases. The construction was completed and mass production started in the 2004 financial year. The second phase is anticipated to be completed in the 2006 financial year. We are entitled to half of the production capacity of Inotera.

Acquisitions and Dispositions

In furtherance of our goal of developing and accessing world class intellectual property and development resources, we have undertaken a number of acquisitions, entered into several joint ventures and made a variety of financial investments. In addition to the arrangements concluded as part of our strategic alliances described above, the main transactions completed in the 2004 financial year are:

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Acquisitions and Joint Ventures

ADMtek

In April 2004, we completed our acquisition of ADMtek Inc., Hsinchu, Taiwan (ADMtek) in exchange for €75 million in cash (of which €6 million is held in escrow subject to the accuracy of the seller s representations and warranties). Payment of an additional €28 million, held in escrow and reflected as restricted cash, is contingent upon employee retention and the achievement of certain performance and development milestones over a two-year period, and is to be recognized as the milestones are achieved. This acquisition was designed to enable access to the Home-Gateway-Systems market for the Wireline Communications segment. ADMtek will offer a complete IC solution package, to complete our portfolio of broadband access products for the central office of feature-rich, multimedia gateway solutions for customer premise equipment. Finally, the newly formed Infineon-ADMtek Co. Ltd adds an R&D centre in Taiwan that is in close proximity to end markets in China and Japan.

Siemens ICM Protocol Stack

In February 2004, we completed the acquisition of assets and assumption of certain liabilities of the Protocol Software operations of Siemens, in exchange for €13 million and the employment of approximately 145 of Siemens mobil communications software engineers. In addition, we entered into a license agreement and amended our product supply agreement with Siemens.

ParoLink

In November 2003, we established a joint venture, ParoLink Technologies Co. Ltd., with United Epitaxy Company, Ltd. (UEC) in which we hold a 56 percent ownership interest. The joint venture, which is based at existing UEC facilities in Taiwan, develops and manufactures lasers and receiver optochips. In connection with our planned disposal of the fiber optics business, we and UEC are in discussion to terminate the joint venture.

Infineon Technologies SC300

In March 2004, we acquired the remaining interest in Infineon Technologies SC300 GmbH & Co. KG, Dresden, Germany, for €278 million. The purchase price was paid by issuing 26,679,255 of our shares. We now hold 100 percent of the interest in SC300. Subsequent to this transaction, SC300 was transformed from a limited partnership (KG) into a general partnership (OHG).

Other transactions

Fiber Optics Divestiture

In April 2004, we entered into an agreement with Finisar Corporation to sell our fiber optics business unit to Finisar for 135 million shares of Finisar common stock. In October 2004, we agreed to modify the terms of this agreement. Pursuant to the agreement as modified, we will receive 110 million shares of Finisar common stock, with an implied value of €115 million based on Finisar s closing share price on October 11, 2004. We have also agreed to provide financial assistance with respect to the costs of restructuring the operations of the business unit and integrating those operations with Finisar s. As part of this transaction, we will transfer to Finisar our fiber optic development, manufacturing and certain marketing activities. Following closing, we anticipate having a 33 percent equity interest in Finisar. The transaction has already received the requisite antitrust clearances in the U.S. and Europe. The transaction is subject to approval by Finisar s shareholders and other customary closing conditions.

Termination of Venture Capital Unit

Beginning in the 1999 financial year, we initiated a program of minority investments in start-up companies through Infineon Ventures, our venture capital unit. Individual investments made through Infineon Ventures typically ranged in size from €0.5 million to €6 million. We invested a total of €11 million in the 2003 financial year and €14 million in the 2004 financial year. Our portfolio of venture capital investments currently comprises some 26 companies in a wide range of electronics related areas. We have also made investments in three venture capital funds active in areas related to our business. In order to reflect current market conditions and based on management judgment of the

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realizable value of each active portfolio company, we recorded impairments of €22 million in the 2003 financial year. We have decided to terminate our venture investing activities and aim to sell our investments. As a result of other-than-temporary declines in fair value and this decision we recorded impairments aggregating €48 million for the 2004 financial year.

Employees

We employed a total of approximately 35,570 employees as of September 30, 2004. For a further description of our workforce by location and function over the past three years, see Operating and Financial Review Other Matters Employees .

A significant percentage of our employees, especially in Germany, are covered by collective bargaining agreements determining remuneration, working hours and other conditions of employment, and are represented by works councils. Works councils are employee elected bodies established at each location in Germany and also at a parent company-wide level (Infineon Technologies AG). Works councils have extensive rights to notification and of codetermination in personnel, social and economic matters. Under the German Works Constitution Act (Betriebsverfassungsgesetz), the works councils must be notified in advance of any proposed employee termination, they must confirm hirings and relocations and similar matters, and they have a right to codetermine social matters such as work schedules and rules of conduct. Management considers its relations with the works councils to be good. A separate works council exists at our subsidiaries in Dresden (Infineon Technologies Dresden GmbH & Co. OHG and Infineon Technologies SC 300 GmbH & Co. OHG). The members of the senior management (Infineon Technologies AG) are represented by a senior management committee *(Sprecherausschuss).*

The collective bargaining agreements pertain to certain of our non-management employees in Germany (affecting approximately 6,800 employees), the Czech Republic (affecting approximately 800 employees) and Austria (affecting approximately 2,490 employees). The agreement in Germany is perpetual, but can be terminated by the trade union with a notice of one month prior to February 28, 2006. The agreement in Austria expires on May 1, 2005. The provisions of these agreements generally remain in effect until replaced through a subsequent agreement. Agreements for periods after expiration are to be negotiated with the respective trade unions through a process of collective negotiations. The agreement in the Czech Republic only covers employees of our fiber optics business, which we have agreed to sell to Finisar.

During the last three years we have not experienced any major labor disputes resulting in work stoppages. During the recent collective bargaining round, in January 2004, approximately 130 employees at our Munich facilities took part in a brief warning strike.

Legal Matters

Rambus. In August 2000, Rambus Inc. (Rambus) filed separate actions against us in the U.S. and Germany. Rambus alleges that our SDRAM and DDR DRAM products infringe patents owned by Rambus.

In May 2001, the Federal District Court for the Eastern District of Virginia (the District Court) dismissed all 57 of Rambus patent infringement claims against us. In addition, the court found that Rambus committed fraud by its conduct in the JEDEC standard setting organization and awarded damages to us. In January 2003 the U.S. Court of Appeals for the Federal Circuit (CAFC) revised the District Court s claim construction on 4 claim terms, and remanded the infringement case back to the District Court for a jury trial. The CAFC also reversed the District Court s finding that Rambus had committed fraud by its conduct in JEDEC. We appealed the CAFC s decision unsuccessfully to the U.S. Supreme Court. On January 8, 2004 the District Court ruled that Rambus infringement case would be limited to four patent claims and would not permit Rambus to assert a variety of related claims. From February 18, 2004 through August 26, 2004 the parties filed a series of related motions and petitions to the District Court. The District Court has scheduled a trial date for February 10, 2005. We believe we have meritorious defenses to the allegations of infringement, and meritorious counterclaims against Rambus that would bar enforcement of the patents.

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Proceedings in the German court began in December 2000 and are still active. An expert report commissioned by the court was rendered in May 2002 but the court has not made a decision on the basis of this report. In September 2002, the European Patent Office (EPO) declared that the Rambus patent had been unduly broadened. Rambus appealed the EPO s declaration, and the EPO ruled at a hearing in February 2004 that Rambus patent was invalid and revoked it. In June 2004 Rambus withdrew its initially filed claims but brought two new patents to the litigation. These patents will be handled by the court in a separate case. We believe we have meritorious defenses to these new allegations of infringement.

SDRAM and DDR DRAM products incorporating the technology that is the subject of the Rambus claims currently constitute substantially all of the products of our Memory Products segment. This segment contributed net sales of €2,926 million and earnings before interest and taxes of €169 million during the year ended September 30, 2004. If we were to be enjoined from producing SDRAM and DDR DRAM products, our financial position and results of operations would be materially and adversely affected, since we would have to discontinue the SDRAM and DDR DRAM product lines or enter into a licensing arrangement with Rambus, which could require the payment of substantial licensing fees.

We currently hold a license under certain RDRAM technology from Rambus, which is not in dispute in the proceedings described above.

On May 5, 2004, Rambus filed a complaint in a California state court against us and our U.S. subsidiary, as well as Siemens, Micron Technology Inc. (Micron) and Hynix Semiconductor Inc. (Hynix), alleging that these DRAM manufacturers had conspired to restrict output an fix prices of Rambus DRAM (RDRAM) in order to prevent widespread adoption of RDRAM as main memory for PCs and to monopolize the worldwide DRAM market. Rambus claims lost royalties of at least one billion dollars and seeks treble damages as well as punitive damages. Based on the allegation raised at the California state court Rambus also filed a complaint against us, as well as Siemens, Micron and Hynix at the European Commission on June 18, 2004. On September 28, 2004 we requested that the European Commission reject this complaint. We plan to vigorously defend against Rambus claims.

U.S. Department of Justice Investigation. On September 15, 2004, we entered into a plea agreement with the Antitrust Division of the U.S. Department of Justice (DOJ) in connection with its ongoing investigation of alleged antitrust violations in the DRAM industry. Pursuant to this plea agreement, we agreed to plead guilty to a single count related to the pricing of DRAM products between July 1, 1999 and June 15, 2002. Under the terms of the agreement, we agreed to pay a fine of $160 million. The fine plus accrued interest is to be paid in equal annual instalments through 2009. On October 25, 2004 the plea agreement was accepted by the U.S. District Court for the Northern District of California. The matter has been therefore fully resolved between us and the DOJ, subject to our ongoing obligation to cooperate with the DOJ in its ongoing investigation of other participants in the DRAM industry. The wrongdoing charged by the DOJ was limited to six OEM customers that manufacture computers and servers. We have entered into settlement agreements with five of these customers and we are negotiating a settlement with the remaining customer.

Civil antitrust claims. Subsequent to the commencement of the DOJ investigation, a number of purported class action lawsuits were filed against us and other DRAM suppliers. Sixteen cases were filed between June 2002 and September 2002 in the following federal district courts: one in the Southern District of New York, five in the District of Idaho, and ten in the Northern District of California. Each of the federal district court cases purports to be on behalf of a class of individuals and entities who purchased DRAM directly from the various DRAM suppliers during a specified time period commencing on or after October 1, 2001. The complaints allege price-fixing in violation of the Sherman Act and seek treble damages in unspecified amounts, costs, attorneys fees, and an injunction against the allegedly unlawful conduct. In September 2002, the Judicial Panel on Multi District Litigation held a hearing and subsequently ordered that the foregoing federal cases be transferred to the U.S. District Court for the Northern District of California (San Francisco) for coordinated or consolidated pretrial proceedings as part of a Multi-District Litigation (the MDL).

Nineteen additional cases were filed between August 2, 2002 and October 15, 2004 in the following state courts: California (five in San Francisco County, one in Los Angeles County, one in

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Santa Clara County and one in Humboldt County), Massachusetts (one in Essex County and one in Middlesex County), Florida (one in Seventeenth and one in Collier County), West Virginia (Brooke County), Kansas (Johnson County), Michigan (Wayne County), North Carolina (Mecklenburg County), South Dakota (Pennington County), Arkansas (Hot Spring County) and Tennessee (Davidson County). Five additional cases were filed through November 3, 2004 in the Vermont (Chittenden Superior Court), New York (New York County), Minnesota (Hennepin County) and Arizona (two in Maricopa County) state courts. Each of these state cases purports to be on behalf of a class of individuals and entities who indirectly purchased DRAM during specified time periods commencing in or after 1999. The complaints allege violations of California s Cartwright Act, unfair competition law and unjust enrichment and seek treble damages in unspecified amounts, restitution, costs, attorneys fees, and an injunction against the allegedly unlawful conduct. In response to a petition filed by one of the plaintiffs, a judge appointed by the Judicial Council of California subsequently ordered that the then-pending California state cases be coordinated for pretrial purposes and recommended that they be transferred to San Francisco County Superior Court for coordinated or consolidated pretrial proceedings. The Massachusetts Essex County and the Florida Collier County cases were ordered transferred to the U.S. District Court for the Northern District of California (San Francisco) for coordinated and consolidated pretrial proceedings as part of the MDL described above.

European Commission Investigation. In April 2003, we received a request for information from the European Commission (the Commission) to enable the Commission to assess the compatibility with the Commission s rules on competition of certain practices of which the Commission has become aware in the European market for DRAM products. We have reassessed the matter after our plea agreement with the DOJ and made an accrual as of September 30, 2004 for a probable minimum fine that may be imposed as a result of the Commission s investigation. Any fine actually imposed by the Commission may be significantly higher than the reserve established, although we cannot more accurately estimate the amount of such actual fine. We are fully cooperating with the Commission in its investigation.

Canadian Competition Bureau Investigation. In May 2004, the Canadian Competition Bureau advised our U.S. subsidiary that it and its affiliated companies are among the targets of a formal inquiry into alleged violations of the Canadian Competition Act in the DRAM industry. No compulsory process (such as subpoenas) has been commenced. The Competition Bureau s inquiry is at a relatively early stage. We are cooperating with the Competition Bureau in its investigation.

Liabilities related to legal proceedings are recorded when it is probable that a liability has been incurred and the associated amount can be reasonably estimated. Where the estimated amount of loss is within a range of amounts and no amount within the range is a better estimate than any other amount or the range cannot be estimated, the minimum amount is accrued. During the years ended September 30, 2003 and 2004, we accrued liabilities in the amount of €28 million and €209 million, respectively, related to the antitrust investigations and related civil claims described above. As additional information becomes available, the potential liability related to these matters will be reassessed and the estimates revised, if necessary. These accrued liabilities would be subject to change in the future based on new developments in each matter, or changes in circumstances, which could have a material impact on our results of operations and financial position.

Securities Class Actions. On October 1, 2004 we learned from press reports that a San Francisco law firm claimed to have filed a class action lawsuit in the U.S. District Court for the Northern District of California. The complaint alleges violations of the U.S. federal securities laws and seeks damages on behalf of a class of purchasers of Infineon Technologies AG publicly traded securities for the period from March 13, 2000 to July 19, 2004. Other press reports indicate that additional class action lawsuits have been filed in U.S. courts based on similar alleged violations of U.S. securities laws and on behalf of purchasers of the same securities for similar periods. Some class action lawsuits appear to extend this period to September 15, 2004. We will vigorously defend ourselves against allegations of U.S. securities laws violations.

An adverse final resolution of the Rambus claims, the antitrust investigations or related civil claims and the securities class action lawsuits described above could result in significant financial liability to, and other adverse effects upon, us, which would have a material adverse effect on our

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business, results of operations and financial condition. Irrespective of the validity or the successful assertion of the above-referenced claims, we could incur significant costs with respect to defending against or settling such claims, which could have a material adverse effect on our results of operations or financial condition or cash flows.

Deutsche Telekom. In October 1999, Deutsche Telekom AG notified us of a potential contractual warranty claim in respect of chips supplied by us for Deutsche Telekom calling cards. The claim relates to damages allegedly suffered by Deutsche Telekom as a result of such cards being fraudulently reloaded by third parties. In September 2001, Deutsche Telekom brought an action in the State Court (*Landgericht*) in Darmstadt, Germany against Siemens, and claimed approximately €125 million. Siemens served third party notice on us on December 21, 2001. In 2003 Deutsche Telekom increased its claim to €150 million. On July 15, 2003, the state court ruled that Deutsche Telekom did not have a valid claim for damages against Siemens and us. Deutsche Telekom has appealed the decision. In September 2004, Deutsche Telekom, Siemens and we finally settled the dispute. In the settlement agreement, we agreed to pay €1 million to cover part of the court fees expensed by Deutsche Telekom and Deutsche Telekom agreed to withdraw its appeal.

Customer complaint. One of our customers notified us on May 18, 2000 that the customer had received a letter from Rambus alleging that one of the components of its product violates Rambus patents. We supplied this customer with the relevant component, and the customer has requested that we indemnify it for any damages it may incur as a result of Rambus claims. The customer s notice to us does not specify any figure for such damages. Accordingly, we cannot predict at this time what our exposure, if any, is likely to be if this customer s claim against us is found to be valid.

ProMOS. On May 7, 2003, ProMOS filed arbitration proceedings against us in Munich under the ICC Arbitration Rules. We had licensed certain DRAM technologies to ProMOS under a license agreement, which we subsequently terminated due to ProMOS material breach. ProMOS was seeking an affirmative judgment that ProMOS was entitled to terminate the license agreement due to our material breach, but to be allowed to continue to use the licensed technology. ProMOS was also seeking damages of approximately $338 million as well as payment of approximately $36 million for DRAM products sold to us. We denied the alleged material breach and requested the arbitration tribunal to dismiss all of ProMOS claims. We also filed counterclaims seeking an affirmative judgment that we were entitled to terminate the license agreement due to a material breach by ProMOS, that ProMOS be required to cease using our DRAM technologies and that we were entitled to damages for the misappropriation of our DRAM technologies of up to $568 million (after deduction of $36 million for DRAM products purchased from ProMOS). However, on November 10, 2004, we and ProMOS reached an agreement regarding ProMOS license of our previously transferred technologies, pursuant to which ProMOS may continue to produce and sell products using those technologies and to develop its own processes and products. As full consideration, ProMOS has agreed to pay us $156 million in four instalments through April 30, 2006, against which our accrued payable for DRAM products of $36 million is to be offset. The parties have agreed to withdraw their claims, including arbitration.

MOSAID. In late 2002, MOSAID Technologies Inc. (MOSAID) alleged that we are violating 11 DRAM-related U.S. patents of MOSAID. In December 2002, we filed an action in the U.S. District Court for the Northern District of California seeking a declaratory judgment that we do not violate such patents. On February 7, 2003, MOSAID filed a counter-suit opposing our motion for declaratory judgment and seeking damages for the alleged patent infringement. On November 3, 2003 MOSAID announced that it has filed an amended counterclaim to add two new patents to its previous claims. This matter has since been consolidated under the federal multidistrict litigation rules with another lawsuit filed by MOSAID against Samsung in the U.S. District Court for the District of New Jersey. A Markman hearing on the patent claim construction was held at the end of January 2004 and a decision on the claim construction was issued on March 23, 2004. A trial will likely be scheduled in the U.S. District Court for the Northern District of California some time in 2005. We intend to vigorously defend against MOSAID s claims. An adverse final resolution could result in significant financial liabilities to, and other adverse effects upon, us, which would have a material adverse effect on our business, results of operations and financial condition.

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Other. We are subject to various other lawsuits, legal actions, claims and proceedings related to products, patents and other matters incidental to our businesses. We have accrued a liability for the estimated costs of adjudication of various asserted and unasserted claims existing as of the end of our financial year. Based upon information presently known to management, we do not believe that the ultimate resolution of such other pending matters will have a material adverse effect on our financial position, although the final resolution of such matters could have a material effect on our results of operations or cash flows in the year of settlement.

Environmental Protection and Sustainable Management

Our global Environmental Management System is designed to eliminate or to minimize possible negative impacts of our manufacturing processes on the environment, our employees and third parties. Most of our production sites worldwide are already included in our multi-site certification under EN ISO 14001. Our sites in Richmond, Virginia (U.S.) and Cegléd (Hungary) successfully carried out their certification audit in the 2004 financial year. We are also planning to integrate the site of SensoNor (Norway) in our multi-site certificate. New production plants including Suzhou (China) will be also included after their ramp-up phase.

Environmental protection means not only complying with legal regulations, but also adherence to a continual process of improvement of our products and the operation of our plants and facilities. It also means educating our staff in environmental issues and motivating them to take part in environmental protection matters. When developing new products or designing our production processes, we attempt to minimize the possible impact of production and our business on the environment. In addition, it is equally important, that our solutions help contribute to creating end products that are environmentally friendly in their own right. For example, Infineon s Mobile-RAM with 1.8 Volt power supply for handheld devices reduces power consumption by up to 80 percent.

Hazardous substances or materials are to a certain extend necessary in the production of semiconductors. However, most of our processes are carried out in closed loops and systems that eliminate the impact of hazardous substances or materials on our employees health and the environment. We regularly test and monitor employees whose work may expose them to hazardous substances or materials, in order to detect any potential health risks and to take appropriate remedial measures by an early diagnosis. As part of the Environmental Management System, we train our employees in the proper handling of hazardous substances.

Where we are not able to eliminate adverse environmental impact entirely, we aim to minimize the impact. For example, we need to utilize PFCs (perfluorinated components) as etching agents in the production of semiconductors. As early as 1992, we started to install exhaust air filter systems to reduce PFC emissions. We are signatories to the Memorandum of Agreement, a voluntary commitment by the European Semiconductor Industry, and also to the Memorandum of Understanding (in the United States) both of which have the goal of reducing overall PFC emissions by 2010 by approximately 10 percent from the emission level of 1995, calculated in CO2 equivalents. This ambitious target is equal to a decontamination of this waste air of about 90 percent, calculated in CO2 equivalents. In the 2004 financial year, we signed a similar commitment for Germany, with a normalized target of 8 percent emission reduction.

Because the damage and loss caused by a fire at a semiconductor facility can be severe, we have constructed and operate our facilities in ways that minimize the specific risks and that enable a quick response if a fire should occur. We expect to continue to invest in fire prevention and response at our facilities.

In connection with our formation, Siemens retained certain facilities located in the United States and certain related environmental liabilities. Businesses that were contributed to us have conducted operations at some of these facilities and, under applicable law, could be required to contribute to the environmental remediation of these facilities despite the fact that these sites were retained by Siemens. We currently know of no further investigations at these sites. We believe its potential exposure, if any, to liability for remediating the U.S. facilities retained by Siemens is therefore low.

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Because some of our facilities are located close to or even shared with those of other companies, including members of the Siemens group, we may need to respond to claims relating to environmental contamination not originating from our own operations.

We believe that we are in substantial compliance with environmental as well as health and safety laws and regulations. There is, nevertheless, a risk that we may become the subject of environmental, health or safety liabilities or litigation. Environmental, health, and safety claims or the failure to comply with current or future regulations could result in the assessment of damages or imposition of fines against us, suspension of production or a cessation of operations. Significant financial reserves or additional compliance expenditures could be required in the future due to changes in law or new information regarding environmental conditions or other events, and those expenditures could adversely affect our business or financial condition.

National legislation enacted pursuant to a recent European Union directive will create significant new obligations regarding the collection, recovery and disposal of electrical and electronic equipment. This directive obligates manufacturers to finance the collection, recovery, and disposal of such products at the end of their useful life. Our products constitute electronic equipment under the terms of this directive. The end-of-life obligations may affect us as suppliers to electrical and electronic equipment producers and as producers of electronic equipment. Because of missing standards and determining factors, it is not clear how the costs of financing the take-back will be shared along the whole supply chain. As one of the results, we are not able at this time to estimate the amount of additional costs that we may incur in connection with this legislation.

Another relevant European directive restricts the use of lead and some types of flame retardant in electronic components beginning in July 1, 2006. In response to market requirements, we started conversion in 2004. Many of our package families are compliant with this aforementioned directive of January 27, 2003.

A proposal for a new European Union regulatory framework for chemicals is in the consultation phase. The new proposal, called REACH, deals with the registration, evaluation and authorization of chemicals. If approved by the appropriate EU bodies and without further modification, this proposal will have a considerable impact not only on producers and importers of chemical substances, but also on downstream users like the semiconductor industry. The availability of chemical substances could be significantly reduced in the European Union, which could have a negative impact on our production as well as research and development activities. We expect to incur significant future costs in connection with this proposal if it is adopted, but we are not currently able to estimate these expenditures.

Real Property

We own approximately 2.0 million square meters of real property at our facilities at Batam (Indonesia), Cegled (Hungary), Dresden (Germany), Munich (Germany), Porto (Portugal), Regensburg (Germany), Richmond (Virginia, USA), Singapore, Suzhou (PR China), Trutnov (Czech Republic), Villach (Austria), Warstein (Germany) and Wuxi (PR China). The Trutnov property will be transferred to Finisar as a part of the sale of our fiber optics business.

In addition, we have long-term rental and long-term lease arrangements in various places in Asia/Pacific, Europe and North America. We believe that these properties are rented or leased on ordinary market terms and conditions.

We have accepted a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG (MoTo) to lease an office complex that is to be constructed by MoTo south of Munich. The office complex will enable us to locate our employees, who are currently situated in various locations throughout Munich, in one central physical working environment. MoTo is responsible for the construction, which is expected to be completed in the second half of 2005. We have no obligations with respect to financing MoTo, and have provided no guarantees related to the construction. The agreement will be accounted for as an operating lease under U.S. GAAP. The agreement is subject to various conditions prior to commencement of the lease.

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MANAGEMENT

Supervisory Board Members
The current members of our supervisory board, their ages, the year in which their current term expires and their principal occupations and other positions as of September 30, 2004 are as follows:

Name	Age	Term expires	Principal occupations and other positions[1]	Compensation as Supervisory Board Member
Max Dietrich Kley *Chairman*	64	2005	Member of the supervisory board of BASF AG *Additional external positions* Chairman of the supervisory board of SGL Carbon AG, Wiesbaden Member of the supervisory boards of: Schott AG, Mainz Heidelberg Cement, Heidelberg *Comparable external positions* Member of the board of administration of Landesbank Rheinland Pfalz, Mainz (until October 11, 2004)	€33,834(2)
Klaus Luschtinetz* *Deputy Chairman* (since January 20, 2004)	61	2009	Chairman of the Infineon central works council Deputy Chairman of the Infineon works council, Munich Balan-/St.- Martin-Strasse *Comparable positions* Member of the board of administration of Siemens Employees Health Insurance, Munich	€38,666
Dr. h.c. Martin Kohlhaussen *Deputy Chairman*	68	2005	Chairman of the supervisory board of Commerzbank AG *Additional external positions* Chairman of the supervisory board of HOCHTIEF AG, Essen Member of the supervisory boards of: Bayer AG, Leverkusen Heraeus Holding GmbH, Hanau Schering AG, Berlin ThyssenKrupp AG, Dusseldorf Verlagsgruppe Georg von Holtzbrinck GmbH, Stuttgart	€43,500
Alfred Eibl*	55	2009	Member of the Infineon works council, Munich Balan-/ St.-Martin-Strasse	€41,087
Dr. Joachim Faber	54	2005	Member of the management board of Allianz AG *Additional external positions* Member of the supervisory boards of: Bayerische Börse, Munich Societa Metallurgica Italiana S.p.A., Florence, Italy	€29,000

Additional company positions
Member of the supervisory boards of:
- Allianz Dresdner Asset Management AG, Munich
- DBI Dresdner Bank Investment Management Kapitalanlagengesellschaft mbH, Frankfurt
- DEGI Deutsche Gesellschaft für Immobilienfonds mbH, Frankfurt
- Deutsche Invest Trust Gesellschaft für Wertpapieranlagen mbH, Frankfurt
- AGF Asset Management S.A., Paris, France

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Name	Age	Term expires	Principal occupations and other positions[1]	Compensation as SupervisoryBoard Member
Günther Fritsch (since March 1, 2004)	69	2005	Industrial manager	€16,916
Jacob Hauser*	52	2009	Member of the Infineon central works council Chairman of the Infineon works council, Munich/-Perlach	€26,584
Dr. Stefan Jentzsch	43	2005	Member of the management board of Bayerische Hypo- und Vereinsbank AG *Additional external positions* Member of the supervisory board of Deutsche Börse AG, Frankfurt *Additional company positions* Chairman of the supervisory boards of: HVB Alternative Investment AG, Vienna, Austria HVB Alternative Financial Products AG, Vienna, Austria DAB Bank AG, Munich *Deputy chairman of the supervisory boards of:* Vereins und Westbank AG, Hamburg HBV Info GmbH, Munich *Member of the supervisory boards of:* Bank Austria Creditanstalt AG, Vienna, Austria HVB Systems GmbH, Munich *Comparable company positions* Chairman of the board of administration of HVB Wealth Management Holding GmbH, Munich	€29,000
Univ.-Prof. Dr.-Ing. Ingolf Ruge	69	2005	Professor at the Technical University Munich	€36,250
Michael Ruth*	44	2009	Infineon Senior Vice President Strategy Planning and Controlling Corporate Logic Representative of senior management *Comparable company positions* Member of the board of administration of ALTIS Semiconductor S.N.C., Essonnes, France	€29,000
Dieter Scheitor*	51	2009	Head of the IT department of IG Metall, Frankfurt	€19,334

Gerd Schmidt*	50	2009	Deputy Chairman of the Infineon central works council Chairman of the Infineon works council, Regensburg	€29,000