

## Operating and financial review

### Important note

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.

This report combines the operating and financial review of Infineon Technologies AG as a part of the global development, manufacturing, sales and marketing network of the Infineon group, with the operating and financial review of the Infineon group as a whole.

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.

Graphs and charts, including their annotations, serve as illustrations and are not part of the operating and financial review.

### 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-Megabit Magnetoresistive 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 (“Finisar”). 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;
  - ::: 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 anti-trust 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 systems 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.

## 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.

### Cyclicalities

The industry's cyclicalities 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 cyclicalities 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 overcapacity 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 commit-

ments for equipment purchases well in advance of planned expansion.

We attempt to mitigate the impact of cyclicity 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 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 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

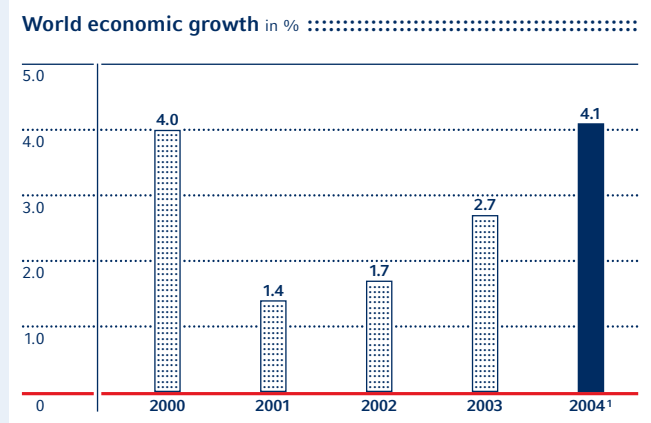
Going forward, our success will remain highly dependent on our ability to stay at the leading edge of technology development, and to continue to optimize our product portfolio. We must achieve both objectives to ensure that we have the flexibility to react to fluctuations in market demand for different 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

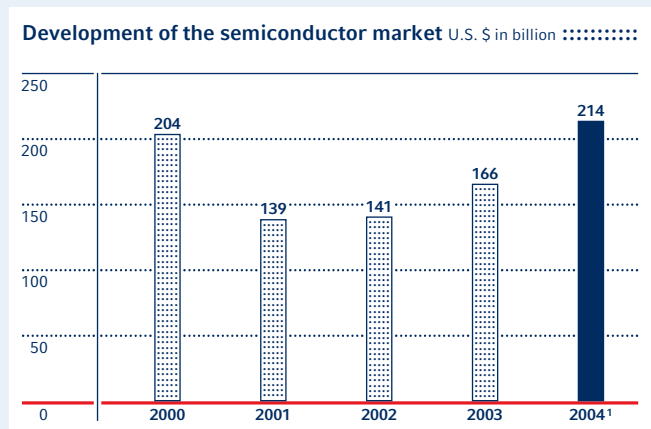
The semiconductor market strengthened significantly during the 2003 calendar year, with growth of 18 percent over the prior year, according to WSTS (World Semiconductor Trade Statistics). In September 2004, WSTS predicted continued growth in the 2004 calendar year of 28 percent over the 2003 calendar 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.



The growing world economy has a positive influence on semiconductor market growth. Source: International Monetary Fund; status: September 2004. <sup>1</sup> Estimated.



Improvement of positive signs in the semiconductor market in the 2004 calendar year. Source: WSTS; status: October 2004. <sup>1</sup> Estimated.

## Results of operations

### Various line items in our consolidated statements of operations expressed as percentages of net sales

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

<sup>1</sup> 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.

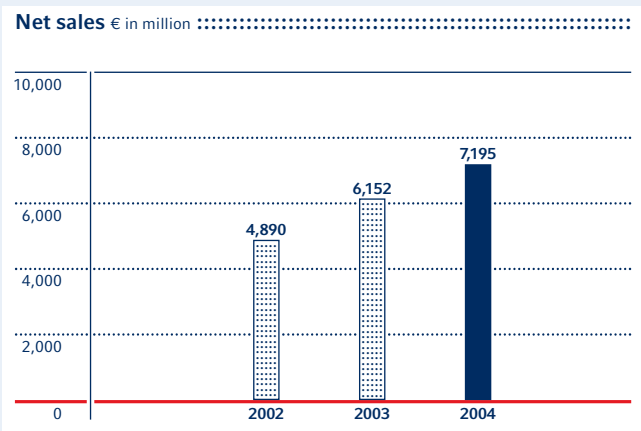
We derive our license revenue from royalties and license fees earned on technology that we own and license to third parties. This enables us to recover a portion of our research and development expenses, and also often allows us to gain access to manufacturing capacity at foundries through joint licensing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

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

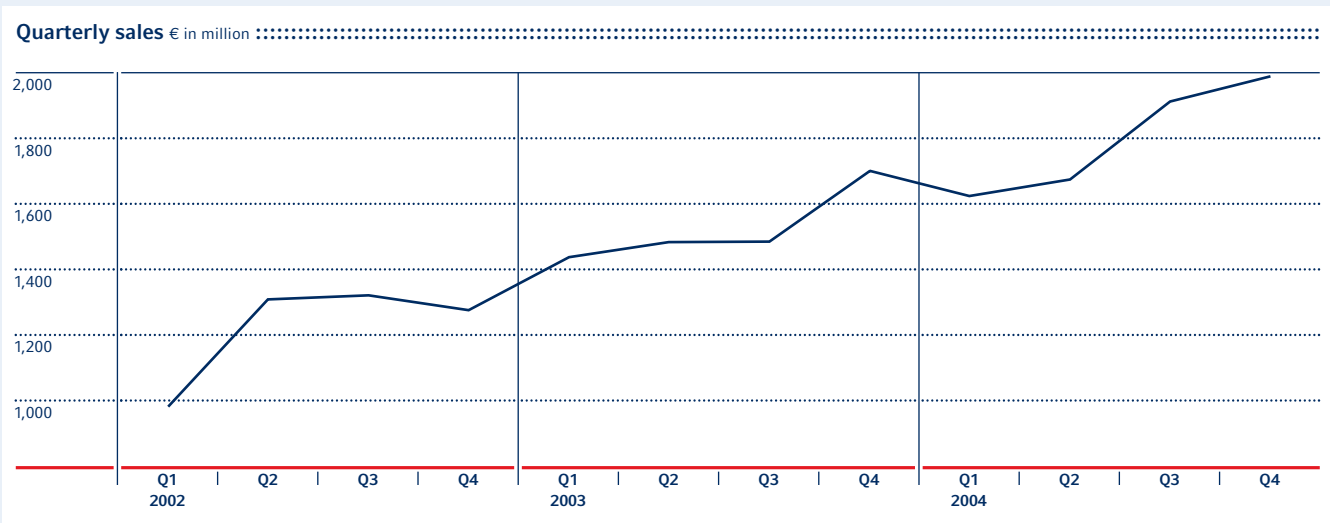
- ::: the market prices for our products, particularly our DRAM products;
- ::: our overall product mix and sales volumes;
- ::: the stage of our products in their respective life cycles; and
- ::: the effects of competition and competitive pricing strategies.

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

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.



Increased demand for our products resulted in higher net sales in the 2004 financial year.



Sales increased sequentially during the 2004 financial year and peaked in the fourth quarter.

## 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.

### ::: 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 optic and optical networking products during the year, although we 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.

For the year ended September 30	2002		2003		2004	
	€ in million	%	€ in million	%	€ in million	%
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	-
<b>Total</b>	<b>4,890</b>	<b>100</b>	<b>6,152</b>	<b>100</b>	<b>7,195</b>	<b>100</b>

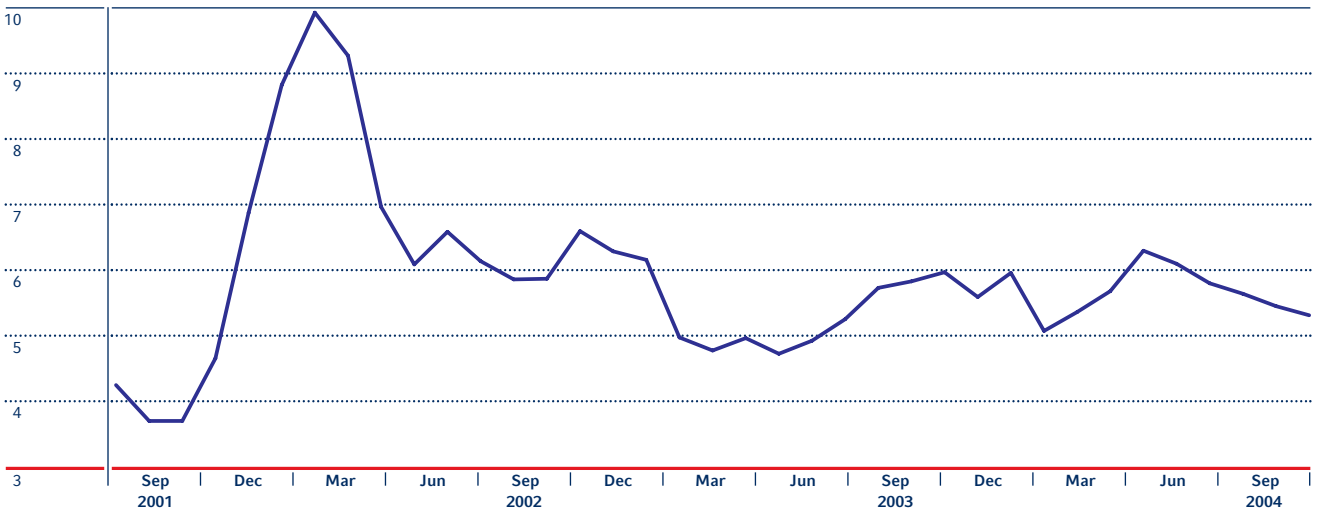
Memory Products

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.

DRAM price development

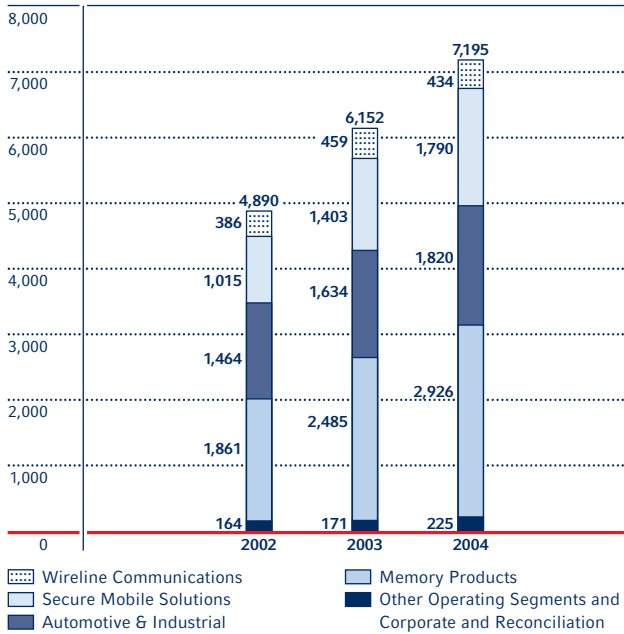
The prices in U.S. dollars of DDR memory ICs were relatively stable during the 2004 financial year, with slight decreases in January, increases in April and decreases during the fourth quarter of the financial year. Contract prices for our principal volume product, 256-Mbit DDR DRAM, were generally stable, 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 the 2004 calendar year, 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.

DRAM price development per 256-Mbit-equivalent in U.S. \$



Source: WSTS.

### Net sales by segments € in million



Higher demand for memory chips and chips for mobile phones resulted in increased net sales 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

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.

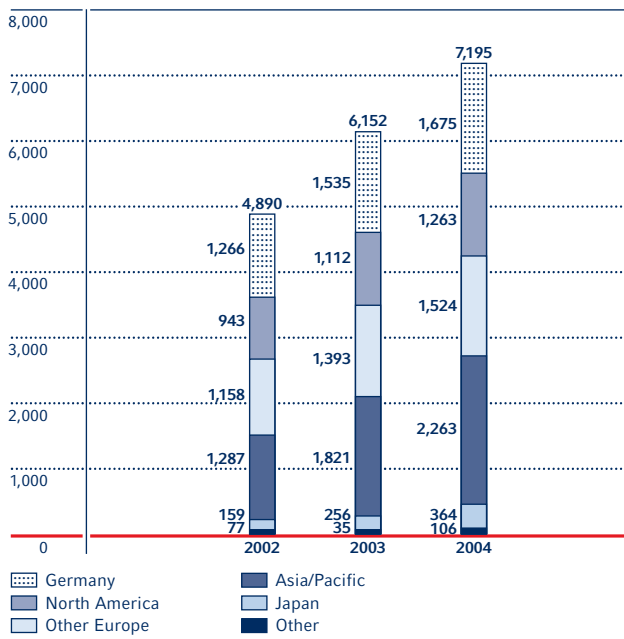
With the increased demand for digital access products, our customer base in Wireline Communications has shifted towards fewer, but larger, customers (reflecting the concentration in the telecommunications industry). The number of customers of our Automotive & Industrial segment remained stable, reflecting 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. The number of Memory Product customers has become increasingly concentrated, and in the 2004 financial year our top ten 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 percent of our net sales in the 2002, 2003 or 2004 financial year.

Net sales by region

For the year ended September 30		2002		2003		2004	
		€ in million	%	€ in million	%	€ in million	%
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
<b>Total</b>		<b>4,890</b>	<b>100</b>	<b>6,152</b>	<b>100</b>	<b>7,195</b>	<b>100</b>

Net sales by region € in million



The region Asia/Pacific again achieved the highest net sales growth.

- ::: 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 January 1, 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.

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;
- ::: Overhead, including maintenance of production equipment, indirect materials, utilities and royalties;

For the year ended September 30

Cost of goods sold € in million

Changes year-on-year

% of net sales

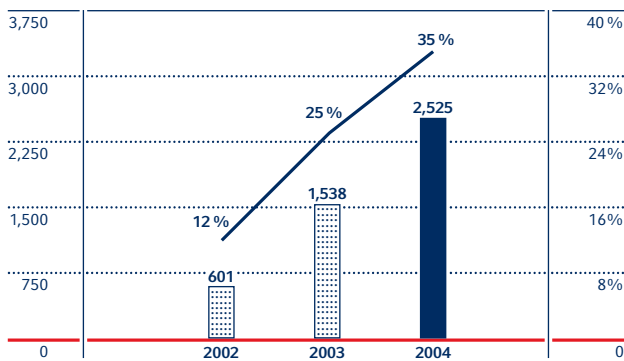
Gross margin

	2002	2003	2004
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:

**Gross margin** absolute and as percentage of sales ::::::::::::::::::::::::::::::::::::::



Gross margin increased significantly through higher utilization of production capacity and improved cost structure.

### ::: 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.

### ::: 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.

For the year ended September 30	2002	2003	2004
<b>Research and development expenses</b> € in million	1,060	1,089	<b>1,219</b>
<b>Changes year-on-year</b>			
<b>% of net sales</b>	22 %	18 %	<b>17 %</b>
<b>In-process R&amp;D charges</b> € in million	37	6	<b>9</b>
<b>% of net sales</b>	1 %	0 %	<b>0 %</b>
<b>Government subsidies</b> € in million	59	59	<b>74</b>
<b>% of net sales</b>	1 %	1 %	<b>1 %</b>

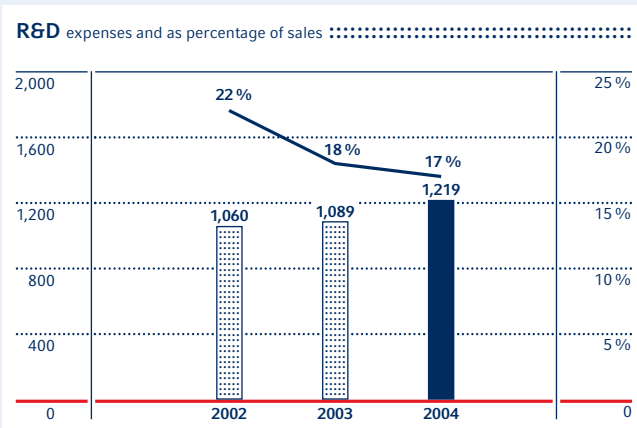
### Research and Development (R&D) expenses

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.

In-process R&D charges relate to specific acquisitions: 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 reduced R&D expenses over the project term as expenses are incurred.



Focused development of manufacturing technologies with high growth potential, particularly Secure Mobile Solutions and Memory Products.

#### ::: 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 cut-backs 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.

### ::: 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.

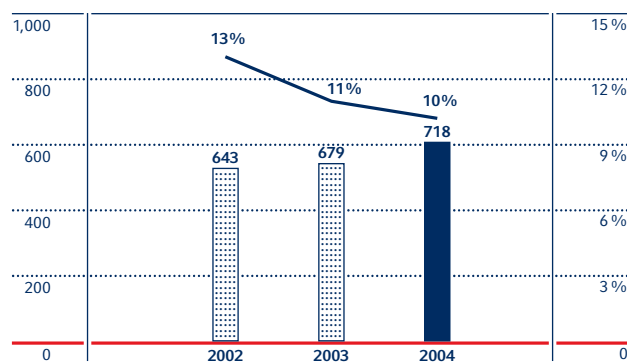
## Selling, General and Administrative (SG&A) expenses

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.

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.

SG&A expenses and as percentage of sales



The efforts for the increased business and legal costs could be partially offset by savings through our impact programs.

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.

For the year ended September 30	2002	2003	2004
<b>Selling, general and administrative expenses</b> € in million	643	679	<b>718</b>
<b>Changes year-on-year</b>		6 %	<b>6 %</b>
<b>% of net sales</b>	13 %	11 %	<b>10 %</b>

## Other items affecting earnings

For the year ended September 30	2002	2003	2004
<b>Restructuring charges</b> € in million	16	29	17
<b>% of net sales</b>	0 %	0 %	0 %
<b>Other operating (income) expense, net</b> € in million	(46)	85	257
<b>% of net sales</b>	(1 %)	1 %	4 %
<b>Equity in (losses) earnings of associated companies</b> € in million	(47)	18	(14)
<b>% of net sales</b>	(1 %)	0 %	(0 %)
<b>Other non-operating (expense) income, net</b> € in million	(41)	21	(64)
<b>% of net sales</b>	(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 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.

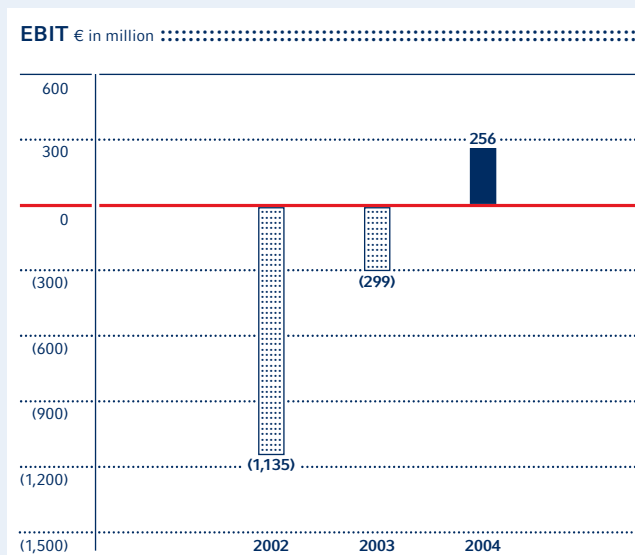
Losses in the 2002 financial year were mainly caused by ProMOS as a result of low DRAM prices. In the 2003 financial year, the recovery in DRAM prices resulted in improved earnings at ProMOS prior to our withdrawal from the venture. Start-up losses at Inotera during the ramp-up phase of production contributed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

### Other non-operating (expenses) 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:



Higher volume and increased margins resulted in improved EBIT.

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

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

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

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 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.

Interest expense since the 2002 financial year principally relates 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.

For the year ended September 30	2002	2003	2004
<b>Interest expense, net</b> € in million	(25)	(52)	<b>(41)</b>
<b>% of net sales</b>	(1 %)	(1 %)	<b>(1 %)</b>

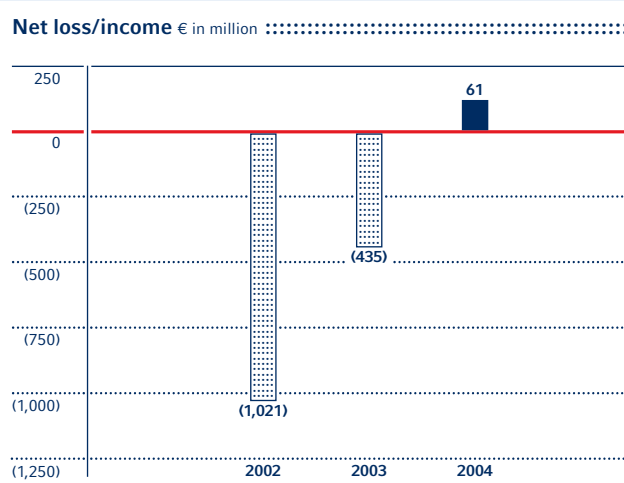
## Income taxes

For the year ended September 30	2002	2003	2004
<b>Income tax benefit (expense) € in million</b>	143	(84)	<b>(154)</b>
<b>% of net sales</b>	3 %	(1 %)	<b>(2 %)</b>
<b>Effective tax rate</b>	12 %	(24 %)	<b>72 %</b>

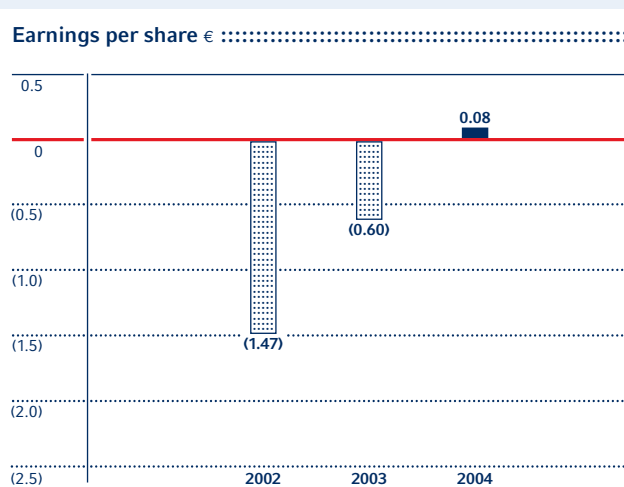
Pursuant to U.S. GAAP, deferred tax assets in tax jurisdictions that have a three-year cumulative loss are subject to a valuation allowance excluding the impact of forecasted future taxable income. In the 2002 financial year, we recorded an increase to the valuation allowance of €271 million, which limited 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 2003 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.



Due to increased demand and higher efficiency of production we returned to profitability.



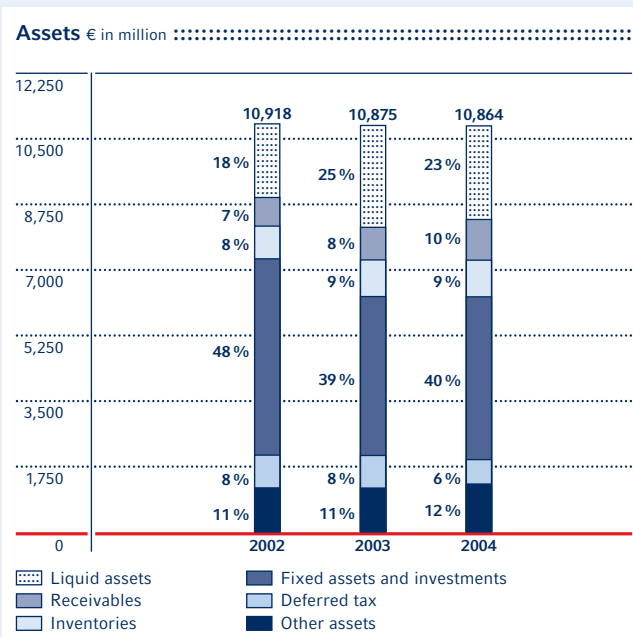
## Financial condition

For the year ended September 30 € in million	2003	2004	Change in %
<b>Current assets</b>	5,376	<b>5,292</b>	(2)
<b>Non-current assets</b>	5,499	<b>5,572</b>	1
<b>Total assets</b>	10,875	<b>10,864</b>	(0)
<b>Current liabilities</b>	2,204	<b>2,870</b>	30
<b>Non-current liabilities</b>	3,005	<b>2,016</b>	(33)
<b>Total liabilities</b>	5,209	<b>4,886</b>	(6)
<b>Shareholders' equity</b>	5,666	<b>5,978</b>	6

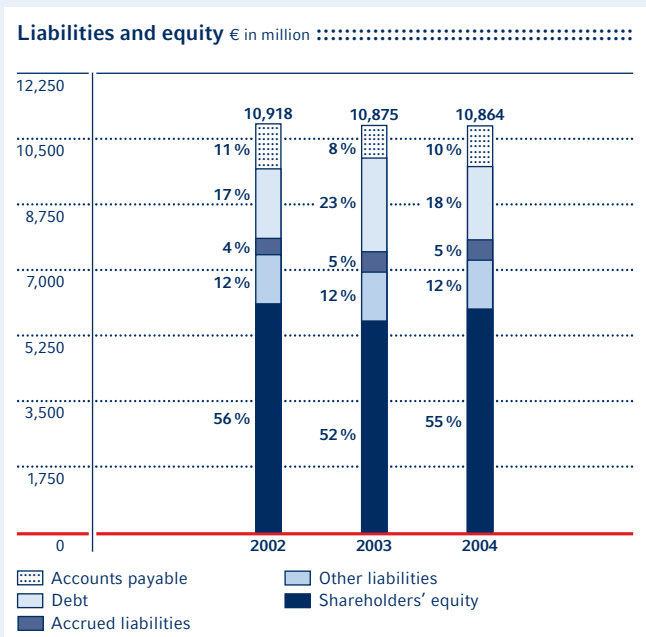
As of September 30, 2004, our total assets were at the same level as at the end of the 2003 financial year. Total current assets decreased at the end of the 2004 financial year due to the net effect of a variety of actions, including the use of cash to repay €549 million of long-term debt, offset by 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.



Liquid assets decreased due to the repayment of debt.



Debt decreased due to the partial redemption of our convertible notes.

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 one percent in the 2004 financial year compared to minus four percent and minus seven 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

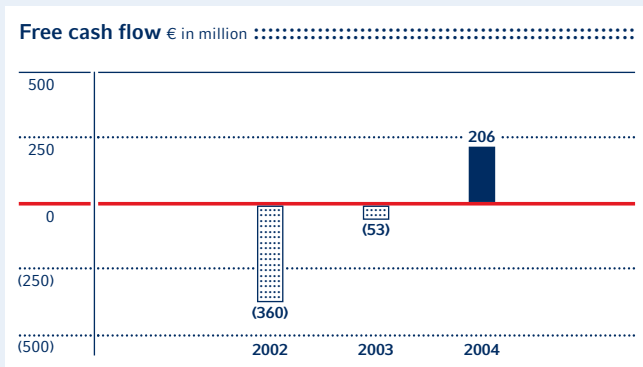
from net income (loss). The changes in balance sheet items in connection with operating activities have been adjusted for the effects of foreign currency exchange fluctuations and for changes in the scope of consolidation. Therefore, they do not conform to the corresponding changes in the respective balance sheet line items.

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.

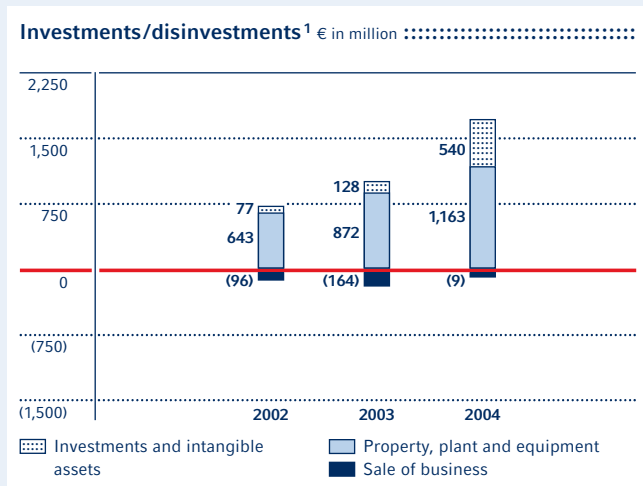
Cash used in investing activities in the 2004 financial year mainly reflects capital expenditures of €1,163 million, principally to equip our plants in Dresden and Richmond, investments of €386 million in associated companies, such as our Inotera joint venture, and net purchases of marketable securities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

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



Higher net cash provided by operating activities led to a positive free cash flow.



Capital expenditures in property, plant and equipment and equity investments contribute to improved productivity and the extension of capacity.  
<sup>1</sup> Without marketable securities.

### 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:

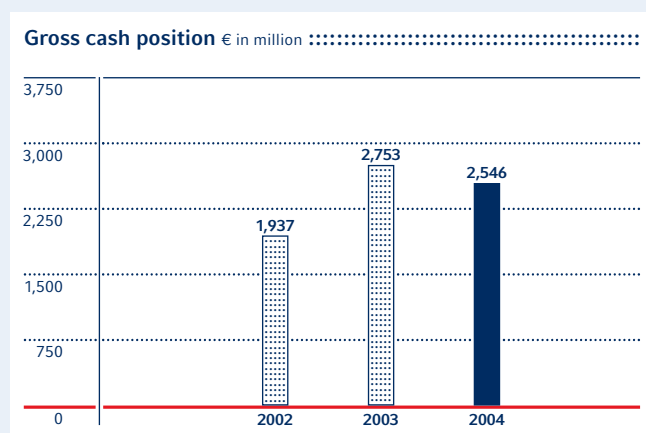
For the year ended September 30 € in million	2002	2003	2004
<b>Net cash provided by operating activities, total</b>	237	730	<b>1,857</b>
<b>Net cash used in investing activities</b>	(1,244)	(1,522)	<b>(1,809)</b>
<b>Purchases of marketable securities, net</b>	647	739	<b>158</b>
<b>Free cash flow</b>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

### 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.

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

Our gross cash position – representing cash and cash equivalents, plus marketable securities – decreased 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.



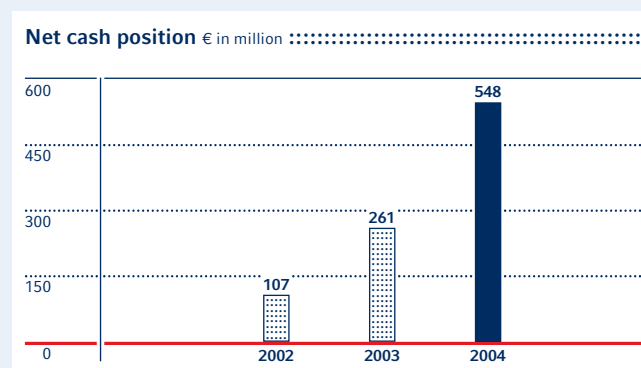
Gross cash position decreased due to the repayment of debt.

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 €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 €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.



Net cash position increased due to improved net income.

## 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:

- ::: 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

As of September 30, 2004 <sup>1,2</sup> , € in million, payments due by period:	Total	Less than 1 year	1–2 years	2–3 years	3–4 years	4–5 years	After 5 years
<b>Contractual commitments:</b>							
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	–	–
<b>Total commitments</b>	<b>2,950</b>	<b>1,564</b>	<b>338</b>	<b>191</b>	<b>212</b>	<b>72</b>	<b>573</b>
<b>Other contingencies:</b>							
Guarantees	419	10	–	304	–	–	105
Contingent government grants <sup>3</sup>	433	58	52	161	126	33	3
<b>Total contingencies</b>	<b>852</b>	<b>68</b>	<b>52</b>	<b>465</b>	<b>126</b>	<b>33</b>	<b>108</b>

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.

### Capital expenditures

Capital expenditures € in million

For the year ended September 30	2002	2003	2004
Memory products	464	576	716
Non-memory products	179	296	447
<b>Total</b>	<b>643</b>	<b>872</b>	<b>1,163</b>

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 is typically 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:

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 multi-currency revolving facility to be used for general corporate purposes. Tranche B replaces our previous €375 million multi-currency 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.

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.

#### Credit facilities € in million

Term	Nature of financial institution commitment	Purpose/intended use	As of September 30, 2004		
			Aggregate facility	Drawn	Available
<b>short-term</b>	<b>firm commitment</b>	<b>working capital, guarantees, cash management</b>	163	73	90
<b>short-term</b>	<b>no firm commitment</b>	<b>working capital</b>	272	–	272
<b>long-term</b>	<b>firm commitment</b>	<b>working capital</b>	724	–	724
<b>long-term<sup>1</sup></b>	<b>firm commitment</b>	<b>project finance</b>	601	601	–
<b>Total</b>			<b>1,760</b>	<b>674</b>	<b>1,086</b>

<sup>1</sup> Including current maturities.

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.

## Employees and Campeon

### Campeon

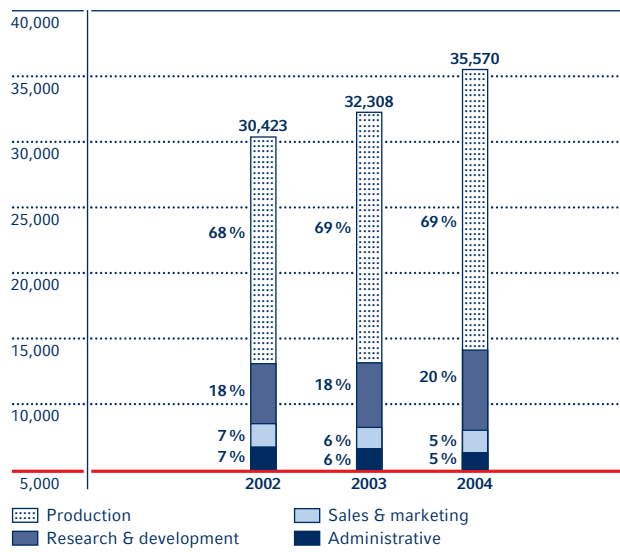
We entered into a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG ("MoTo") to lease an office complex being constructed by MoTo south of Munich, Germany. The office complex will enable us to locate our employees, who are currently situated in various locations throughout Munich, 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.

### 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
<b>Function:</b>			
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
<b>Total</b>	<b>30,423</b>	<b>32,308</b>	<b>35,570</b>
<b>Region:</b>			
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
<b>Total</b>	<b>30,423</b>	<b>32,308</b>	<b>35,570</b>

Employees by function<sup>1</sup>



Reduction of workforce within sales & marketing as well as administrative for the benefit of research & development.

<sup>1</sup> Columns may not add up due to rounding.

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.

## Risks and opportunities

### Remark

Within the semiconductor industry periods of growth are historically followed by periods of market contraction. Such periods of market contraction are characterized by surplus capacity, order cancellations as well as price erosion and sales volume reductions. The risks associated with the cyclical nature of this business are compounded by the need for large scale capital investments in order to sustain market leadership as well as the sector's rapid pace of technological change. These risks are, however, often accompanied by substantial opportunities.

### Infineon risk management system

Given the volatility of the business cycle in the semiconductor industry it is very important to be able to react quickly to changing market requirements. To this end we have established a risk and opportunity management system with the goal of enabling us both to exploit the many significant opportunities manifesting themselves in our markets and to anticipate and identify risks associating or arising from them. An enterprise-wide system of risk and opportunity reporting is a central element of our risk and opportunity management system. The scope and depth of reporting helps to enable corporate management to take quick and effective actions whenever situations so require. Within every organizational unit of the company risk officers or risk reporters have been designated to implement and execute the risk and opportunity reporting process. According to the guidelines for this process risks and opportunities are identified within the framework of a risk and opportunity categorization model, accompanied by an evaluation of each risk and opportunity based on its respective probability and effect upon EBIT. The risk management system is extensively documented in our intranet and thus accessible by our employees worldwide. The reporting system is based upon individual observations of risk and opportunity and is composed of a range of monitoring and management processes embedded in our core processes. It commences at the level of strategic planning and continues through the manufacturing and sales operations, including the processing of receivables. As an extension of the forecasting processes conducted by the business

groups, the sales organization, the manufacturing clusters and the central functions, the risk and opportunity system is used to identify and evaluate possible deviations from expected developments. Beyond the identification and evaluation of major developments that may effect the business, the system is also used to prioritize and implement activities to enhance opportunities and mitigate or reduce our risk.

Risk and opportunity reports are issued on a regular basis by all of our business units. These reports form the core of the risk management system. The reports are examined and evaluated by the management board and business group management as part of their reviewing process.

Alongside the enterprise-wide reporting system a number of other early-warning systems have been established to enhance our abilities to control and manage risks and opportunities throughout the organization. In particular a balanced-scorecard system has been developed and implemented as a pivotal instrument to monitor and manage the company's key performance indicators. In addition, a quantitative risk analysis approach has been introduced to our research and development activities in order to plot possible scenarios, to provide greater transparency of risks and prioritize measures designed to enhance the probabilities of success of these activities. Furthermore the quantitative risk analysis methodology is being applied to financial decision making processes, in particular to investment decisions and forecasting processes. The goal of employing this methodology is to assure that appropriate risk mitigation and opportunity enhancement strategies are chosen and implemented.

The systematic development of existing systems of risk analysis and the creation of new early warning systems substantially contribute to the enhancement and sustainability of a risk and opportunity culture within the company. This is supported by regular Risk & Opportunity Forum meetings involving the risk officers of the company. These meetings provide a communication platform for exchanging ideas and information on risk analysis and risk management; they furthermore provide a basis for the creation of awareness of this important subject matter throughout the company.

In the course of an annual Risk Management System Analysis ("RMSA") our Business Groups and Central Functions are called upon to review the effectiveness and efficiency of the key elements of the Infineon Risk and Opportunity Management System. This is executed via self-assessment using a questionnaire which is crafted to facilitate improvements and support the audit process, both by our internal and external auditors.

Our risk and opportunity reporting system has been evaluated by the external auditors as part of the annual audit process. The external auditors have confirmed that the Management Board has fulfilled its obligation according to para. § 91 subsection 2 of the German Law on Stock Companies ("Aktiengesetz"), which calls for the creation of a reporting system which enables management to receive early warning of developments which may endanger the existence of the company as a whole.

**Global business risks**

Substantial changes in regional business environments around the globe may have adverse affects on our business and results of operations.

Our global business strategy implies that we maintain research and development locations as well as manufacturing sites in many countries around the world. This may be the result of strategic decisions to enhance our cost competitiveness, overcome market entry hurdles or enhance opportunities related to technology development. More than half of our sales volume is generated outside of Europe. With the expected growth rates of Asian countries in the near future we expect our investments to increase in this region. Therefore risks could develop based upon:

- ::: negative economic developments in foreign economies and instability of foreign governments, including the threat of war 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 affect on our business and results of operations. It cannot be excluded that regional crisis like the SARS epidemic in 2003 will not have any negative effects on our business or profitability. However, broad diversification within our product portfolio and the spread of development and manufacturing locations around the world provide an effective approach to mitigate the overall risk of such regional crisis as the dependencies are generally reduced.

**Risks related to our operations**

From our Memory Product segment the volatility of DRAM-Memory prices remains the most important risk but also the most prominent opportunity both for this segment as well as for the company as a whole. Through our entry into the market for flash memory products we are expanding our product portfolio which carries both opportunities but also substantial risks. Our operational risks have nonetheless decreased in comparison to last year by virtue of the fact that we have successfully transitioned a major portion of our memory product manufacturing technology to the new 110-nanometer geometry. On the whole we are looking towards a well-balanced portfolio of risks and opportunities.

In the Logic segments we are looking at substantial market risks, although the growth outlook is still positive, particularly in the product lines serviced by our Secure Mobile Solutions and Wireline Communications segment. Downward price pressure is a risk which currently overshadows the current markets.

The semiconductor industry is characterized by the introduction of new technologies with the risk of substantial ramp-up delays and volatility in yields. We attempt to deal with these risks through sophisticated project management processes and an intensive system of process monitoring.

To help protect against the occurrence of product-related risks, we have established a network to monitor the quality of our operations and those of our important suppliers. We have secured certification for all of our production facilities according to the TS 16949:2002 standard.

We have procured insurance coverages to limit the impact of losses, incidents or certain other events posing possible perils and threats to our assets, finances or earnings.

In the area of intellectual property the company has signed a number of cross-license agreements with other companies. The company is working intensively to increase the number and scope of such cross-licence agreements with other companies in order to reduce the risk of claims for patent infringement.

Tax, fair trade and stock exchange regulations can all supply a basis for additional risks. To mitigate the cause and effect of these risks we rely upon the counsel of professionals, including both the advice of our own employees as well as the advice of independent service providers.

## Market risks

### Exchange rate risks

Our involvement and participation in various regional markets around the globe creates cash-flows in a number of different currencies – primarily in U.S. dollars. Since we are exposed to fluctuating currencies and substantial volatility relating to exchange rates, the management of these risks becomes an important issue.

A major portion of our sales volumes as well as the costs relating to the design, production and manufacturing of products are based in U.S. dollars, not in euros. Exchange rate fluctuations may have substantial effects on our sales figures, our costs and our overall profits.

Our policy with respect to limiting short-term foreign currency exposure generally is to economically hedge at least 75% 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. Parts 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. The remaining risk is controlled by value at risk parameters.

### Interest rate risk management

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, our current assets are kept at a high level. These assets are mainly deposited in instruments with short-term interest rates. To reduce the risk caused by changes in the market interest rates, the duration of the interest rates of our debts and current assets are aligned by the use of interest rate derivatives.

### Commodity price risk

We are exposed to commodity price risks with respect to raw materials used in the manufacture of our products. We seek

to minimize the risks through our sourcing policies and operating procedures. We do not utilize derivative financial instruments to manage any remaining exposure to fluctuations in commodity prices.

### Financing risks

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. These capital requirements should generally be addressed by incoming cash-flow, the use of available credit lines, available public funding for projects and – depending upon market conditions – capital market offerings. Although we have applied for financial support from public authorities on a number of projects, we may not be able to guarantee that we will be able to raise the amount of capital required for our business from these sources in a timely and successful fashion. We intend to continue the policy of cooperation with other semiconductor companies to share the costs of research and development as well as in the creation of joint production facilities.

### Legal risks

As this applies to many companies within the semiconductor industry, so has Infineon been exposed to patent claims, claims relating to alleged defective or faulty products, claims relating to the alleged transgression of environmental rules or regulations and other general liability claims. Regardless of the outcome of these claims, the company may sustain substantial costs in defending itself against these claims. Infineon intends to exert substantial efforts in defending itself against unfounded claims including the support of internal and external experts.

### Overall risks

At no time during the past financial year have we been aware of any substantial risks which would have threatened the existence of the company. Risks which may endanger the existence of the company are currently not visible.

Additional descriptions relating to risks may be found in the notes to the consolidated financial statements included in this report as well as the annual "Report on Form 20-F".

## Infineon Technologies AG

Infineon Technologies AG is the parent company of the Infineon group and carries out the group's management and corporate functions. Infineon Technologies AG has major group-wide responsibilities such as finance and accounting, human resources, strategic and product-oriented research and development activities as well as worldwide corporate and marketing communications. The responsibility for managing the flows of supplies, products and services among the group companies is also handled by Infineon Technologies AG. Infineon Technologies AG has its own production facilities in Munich and Regensburg.

Infineon Technologies AG prepares its financial statements on a stand-alone basis in accordance with the requirements of the German commercial code (HGB). The complete financial statements are published separately.

### Statements of operations<sup>1</sup> (condensed) € in millions

For the year ended September 30,	2002	2003	2004
<b>Net Sales</b>	6,765	8,122	<b>8,852</b>
<b>Cost of goods sold</b>	(6,669)	(7,201)	<b>(7,325)</b>
<b>Gross profit</b>	96	921	<b>1,527</b>
<b>Operating expenses</b>	(1,358)	(1,460)	<b>(1,533)</b>
<b>Other income</b>	580	252	<b>136</b>
<b>Loss before tax</b>	(682)	(287)	<b>130</b>
<b>Income tax</b>	65	0	<b>0</b>
<b>Net (loss) income</b>	(617)	(287)	<b>130</b>
<b>Accumulated loss brought forward</b>	(435)	(1,052)	<b>(1,339)</b>
<b>Accumulated loss at end of year</b>	(1,052)	(1,339)	<b>(1,209)</b>

<sup>1</sup> Prepared in accordance with the German GAAP (HGB).

During the financial year ended September 30, 2004, net sales and net income increased due to higher demand for our products and beneficial price development, especially for memory products. Infineon Technologies AG handles the settlement of accounts for and with its subsidiaries that produce and sell products. As a result, Infineon Technologies AG's sales on a stand-alone basis were higher than those of the Infineon group as a whole.

### Balance sheets<sup>1</sup> (condensed) € in millions

As of September 30,	2003	2004
<b>Fixed and intangible assets</b>	794	<b>768</b>
<b>Investments</b>	5,390	<b>5,733</b>
<b>Non-current assets</b>	6,184	<b>6,501</b>
<b>Inventories</b>	461	<b>470</b>
<b>Receivables and other assets</b>	1,980	<b>1,992</b>
<b>Cash and marketable securities</b>	2,641	<b>2,395</b>
<b>Current assets</b>	5,082	<b>4,857</b>
<b>Total assets</b>	11,266	<b>11,358</b>
<b>Shareholders' equity</b>	6,774	<b>7,182</b>
<b>Accrued liabilities</b>	612	<b>798</b>
<b>Payables and other liabilities</b>	3,880	<b>3,378</b>
<b>Total liabilities and shareholder's equity</b>	11,266	<b>11,358</b>

<sup>1</sup> Prepared in accordance with the German GAAP (HGB).

Infineon Technologies AG's financial position showed an increase in investments, and a decrease in cash and marketable securities which was principally caused by our investments in Inotera, SC300 and Eupec, partially offset by a capital decrease at Infineon Technologies Holding B.V., Netherlands. Total liabilities decreased due to reduced payables, which partially offset the increase in accrued liabilities, primarily in connection with antitrust investigations, an increase in shareholders' equity, due to the issuance of ordinary shares relating to the acquisition of the remaining interest in SC300 and 2004 net income. Infineon Technologies AG's shareholders' equity ratio was 63 percent as of September 30, 2004 (2003: 60%).

### Dividend

The financial statements on a stand-alone basis of Infineon Technologies AG in accordance with the HGB requirements for the 2003 financial year showed a net loss, therefore no dividend was distributed. A net loss was also incurred for the 2004 financial year and therefore a dividend cannot be distributed.

## 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 of 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.
- ::: 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.

Munich, November 2004  
**Management Board**