

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 Report" 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 2006 Financial Year

In our 2006 financial year, which ended September 30, both the global economy and the semiconductor market were slightly stronger than in the prior year. As a global player in the semiconductor market, we were influenced by these more favorable macroeconomic and market conditions. In spite of these improved market conditions, we were also impacted by ongoing strong pricing pressure in all of our operating segments. The following were the key developments in our business during the 2006 financial year:

- > Our net sales increased by 17 %, from €6,759 million in the 2005 financial year to €7,929 million in the 2006 financial year. Our earnings before interest and taxes (EBIT) increased from negative €183 million in the 2005 financial year to negative €15 million in the 2006 financial year. Our cash flow from operations decreased from €1,039 million in the 2005 financial year to €974 million in the 2006 financial year.
- > In August 2006, Qimonda, our memory business, successfully completed an initial public offering on the New York Stock Exchange of 42 million new ordinary shares, together with 6.3 million existing shares from Infineon in an over-allotment option, at a price of \$13 per share. We incurred aggregate charges of approximately €80 million primarily in connection with the formation of Qimonda, the dilution of our interest in Qimonda following its initial public offering, as well as our sale of Qimonda shares upon exercise of the underwriters' over-allotment option.
- > In March and May 2006, our joint venture Inotera Memories, Inc. ("Inotera") successfully completed an initial public offering on the Taiwanese Stock Exchange of 200 million ordinary shares and a public offering on the Luxembourg Stock Exchange of 40 million global depositary shares (representing 400 million ordinary shares), each at an issuance price of NT\$33 per ordinary share. As a result of these transactions, we recognized non-operating gains of €72 million.
- > In June 2006, we and MOSAID Technologies Inc. ("MOSAID") reached agreements settling all claims between us and licensing to us the MOSAID patent portfolio for use in our current and future products. Under the terms of the settlement agreements, MOSAID purchased fifty patents from us. We retain royalty-free "lives of the patents" licenses to use these patents in the manufacturing and sale of any products. In addition, MOSAID granted us a six year license to use any MOSAID patents in the manufacturing and sale of semiconductor products, as well as a "lives of patents" license to those MOSAID patent families that had been in dispute.
- > In August 2006, Infineon and Qimonda entered into settlement agreements with Tessera Inc. ("Tessera") with respect to all of Tessera's patent-infringement and anti-trust-related claims. Pursuant to the settlement, Infineon and Qimonda entered into six-year license agreements with Tessera that provide Infineon

- and Qimonda a world-wide, non-exclusive, non-transferable and non-sub licensable license to use a portfolio of Tessera patents.
- > We recognized charges of €91 million in the 2006 financial year within the Communication Solutions segment, primarily in connection with the insolvency of BenQ's German subsidiary.
 - > We continued to invest heavily in research and development and achieved a number of significant milestones during the year, including the introduction of:
 - > highly-secure identification chips for the new United States government electronic passport, designed to facilitate international travel by allowing automatic identity verification, faster immigration inspections and greater border protection and security;
 - > the most advanced 32-bit embedded flash microcontrollers for automotive applications in series production, making us the first semiconductor manufacturer worldwide to achieve high-volume output of embedded flash products using 130-nanometer technology;
 - > a family of 100V MOSFET devices that can reduce the parts count in switched mode power supplies (SMPSs) by 30 %, and reduces losses of up to 20 %, compared to solutions based on standard technologies. OptiMOS® 2 offers optimum performance in AC/DC and DC/DC power conversion applications in computer servers, and telecommunications and networking systems;
 - > SMARTi® 3GE, the world's first one-chip, six-band WCDMA (Wideband Code Division Multiple Access) and quad-band EDGE radio frequency transceiver for mobile phones manufactured in RF CMOS technology;
 - > S-GOLD®3H, a baseband processor for mobile phones supporting next-generation HSDPA (High-Speed Downlink Packet Access) data rates of up to 7.2 megabits per second (Mbit/s);
 - > E-GOLDvoice™, a GSM single-chip for mobile phones which integrates a baseband processor, radio frequency transceiver, power management unit and RAM, achieving a new record level of silicon integration for mobile communications; and
 - > Danube™, a single-chip solution for ADSL2+ broadband IAD (integrated access device) and home gateway applications enabling services such as VoIP, video-conferencing and IPTV.
 - > Qimonda likewise achieved a number of significant milestones during the year, including:
 - > the introduction of DDR2 Fully-Buffered DIMMs in high volume as a new technology for Intel's Bensley server platforms;
 - > the introduction of the industry's first DDR3 SO-DIMM samples to ATI for future notebook designs; and
 - > becoming the preferred supplier of GDDR3 Graphics RAM for Microsoft's game console Xbox 360.
 - > As part of our ongoing project to improve our production processes and expand our production capabilities, we:
 - > opened our first Asia-based front-end power fab located in Kulim Hi-Tech Park, Malaysia. We plan to invest approximately \$1 billion in this production facility. Maximum capacity will be approximately 100,000 wafer starts per month using 200-millimeter wafers. The new facility will produce power and logic chips used in industrial and automotive power applications;
 - > developed additional 130-nanometer process options to fulfill the needs of specialty applications;
 - > achieved significant progress in our advanced 65-nanometer logic technology, with the successful manufacture of our first cell-phone chips;
 - > are developing a 45-nanometer logic technology, with the first working circuits in 45-nanometer logic technology already proven in silicon;
 - > signed an agreement with Chartered Semiconductor Manufacturing Ltd. ("Chartered Semiconductor") regarding the manufacturing of 65-nanometer logic products;
 - > finalized the first phase of the ramp-up of the new 300-millimeter manufacturing module at Richmond with a capacity of 25,000 wafer starts per month;
 - > announced with Nanya Technology Corporation ("Nanya") that we have successfully qualified the next generation 75-nanometer DRAM trench technology and the first 512M DDR2 product that has been jointly developed at Qimonda's R&D centers in Dresden and Munich, Germany; and
 - > expanded our foundry relationship with Winbond Electronics Corp., Hsinchu, Taiwan ("Winbond") to include the transfer of next generation 80-nanometer DRAM trench technology.

Our Business

We design, develop, manufacture and market a broad range of semiconductors and complete system 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 three principal operating segments serving various markets in the semiconductor industry:

- > Our Automotive, Industrial & Multimarket segment designs, develops, manufactures and markets semiconductors and complete system solutions primarily for use in automotive, industrial and security applications, and applications with customer-specific product requirements.

- > Our Communication Solutions segment designs, develops, manufactures and markets a wide range of ICs, other semiconductors and complete system solutions for wireline and wireless communication applications.
- > Our majority-owned subsidiary Qimonda designs memory technologies and develops, manufactures, markets and sells a large variety of memory products on a module, component and chip level.

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

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 for Qimonda, are increasingly true for our Communication Solutions segment, and have the least impact on our Automotive, Industrial & Multimarket segment.

Cyclicality

The industry's cyclicality results from a complex set of factors, including, in particular, fluctuations in demand for the end products that use semiconductors and fluctuations in the manufacturing capacity available to produce semiconductors. This cyclicality is especially pronounced in the memory 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 more than one of these newly built fabs comes on-line at about the same time, the supply of chips to the market can be vastly increased. Without sustained growth in demand, this cycle has typically led to manufacturing over-capacity and oversupply of products, which in turn has led to sharp drops in semiconductor prices. When prices drop, manufacturers have in the past cut back on investing in new fabs. As demand for chips grows over time, without additional fabs coming on line, prices tend to rise, leading to a new cycle of investment. The semiconductor industry has

generally been slow to react to declines in demand, due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of planned expansion.

We and Qimonda attempt to mitigate the impact of cyclicality by investing in 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 Qimonda, in particular, can improve its gross margin by focusing on two key areas: the continuous improvement of cost structure and productivity through the introduction of advanced memory process technologies and the development and marketing of a broader range of memory products, focusing particularly on higher margin and less volatile applications such as infrastructure, high-end graphics, consumer and mobile applications.

Substantial Capital and R&D Expenditures

Semiconductor manufacturing is very capital-intensive. The manufacturing capacities that are essential to maintain 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 nearly 50 % of the industry's projected 2006 capital spending budgets. 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, particularly at Qimonda.

To reduce our total costs, we also 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. Qimonda, for example, is developing future DRAM technologies with feature sizes of 58-nanometer together with Nanya. In addition, Qimonda has established foundry relationships with partners in Asia, including Semiconductor Manufacturing International Corporation, Shanghai, China ("SMIC"), and Winbond Electronics Corp., Hsinchu,

Taiwan (“Winbond”), to increase its manufacturing capacities, and therefore its potential revenues, without investing in additional manufacturing assets. In our logic area, our principal alliances are with International Business Machines Corporation (“IBM”), New York, United States of America, Chartered Semiconductor Manufacturing Ltd., Singapore (“Chartered Semiconductor”) and Samsung Electronics Co. Ltd., Seoul, Korea (“Samsung”) for CMOS development and manufacturing at 65-nanometer and 45-nanometer process technologies, with United Microelectronics Corporation, Taipei, Taiwan (“UMC”) for 90-nanometer manufacturing, and with IBM through our manufacturing joint venture ALTIS Semiconductor S.N.C. (“ALTIS”) in Essonnes, France.

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, the majority of Qimonda’s capacity is based on 110-nanometer structure sizes. In addition, 90-nanometer technology is currently in ramp-up and Qimonda has already started commercial production based on 75-nanometer structure sizes, jointly developed with Nanya. Qimonda has extended its 300-millimeter capacity share during the 2006 financial year with the continuous ramp up of the facilities of Inotera, its joint venture with Nanya, and the ramp-up of foundry capacities at SMIC in Beijing, Winbond in Taichung and Qimonda’s own facility in Richmond. Qimonda plans to further extend the share of its memory production on 300-millimeter wafers with the continuous ramp-up of the 300-millimeter line in Richmond and at the joint venture Inotera. In our logic area, the majority of our capacity is based on 130-nanometer structure sizes. Our 130-nanometer logic process technology, with up to eight layers of copper metallization, is in full production at several manufacturing sites, including our Dresden facility and our manufacturing joint venture with IBM in Essonnes, France. Additional 130-nanometer process options have been developed to fulfill the needs of specialty applications. Our 90-nanometer logic technology is in production and our first cell-phone chips in our advanced 65-nanometer logic technology have been successfully manufactured. In addition, we are in the process of developing a 45-nanometer logic technology. The first working circuits in 45-nanometer logic technology were proven in silicon in financial year 2006.

With our planned investment of approximately \$1 billion in the Kulim power manufacturing facility, we will increase our manufacturing capacity mainly for automotive and industrial power products by up to 100,000 wafer starts per month using 200-millimeter wafers. At full capacity, this manufacturing facility is expected to employ about 1,700 people.

Technological Development and Competition

Sales prices per unit are volatile and generally decline over time due to technological developments and competitive pressure. Memories 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 net sales by optimizing product mix, by increasing unit sales volume and by continually reducing per-unit production costs. The growth in volumes depends in part on productivity improvements in manufacturing. By moving to ever-smaller structure sizes, 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 % and 45 % per year and, assuming constant costs per square inch of silicon, to an approximately 30 % cost reduction per bit per year.

Seasonality

Our business is affected by seasonality, with sales historically strongest in our fourth financial quarter and weakest 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 memory 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. 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 its expected useful life. The value of such acquired IP is often complex and difficult to estimate. We also derive modest revenues from the licensing of our IP, generally pursuant to cross licensing arrangements.

Challenges that lie Ahead

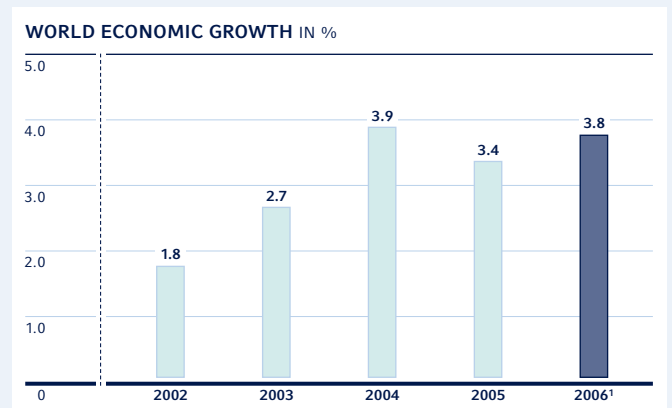
Going forward, our success will remain highly dependent on our ability to stay at the leading edge of technology development, and to continue to optimize our product portfolio. We must achieve both objectives to ensure that we have the flexibility to react to fluctuations in market demand for different types of semiconductor products. We believe that the ability to offer and the flexibility to 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 2006 Financial Year

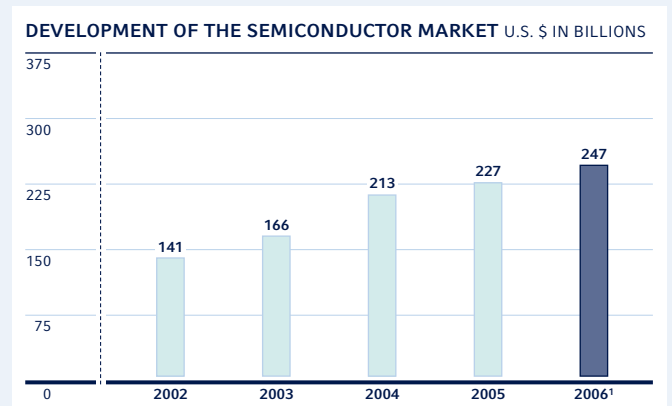
The growth of the semiconductor market accelerated only slightly through the first three quarters of the 2006 calendar year following growth of 7% in the 2005 calendar year, according to WSTS (World Semiconductor Trade Statistics). In October 2006, WSTS predicted a growth rate of 8% for the full 2006 calendar year. According to WSTS, sales in North America are expected to increase by 11% in the 2006 calendar year. The semiconductor market in Asia-Pacific is expected to increase by 11%; the Japanese market is expected to grow by 7%; the European mar-

ket is expected to increase slightly by 1%. Sales of non-memory products (logic chips, analog, discrete and optical components), which accounted for 78% of the entire market in the first half of the 2006 calendar year, are predicted to grow by 6% compared with the 2005 calendar year. Sales of memory products are predicted to grow by 17% compared with the 2005 calendar year.

Gartner Dataquest predicts worldwide growth in the 2006 calendar year of 12% for semiconductors in the communications business (wireless and wireline). Sales of semiconductors for industrial electronics are predicted to grow by 15%, for automotive electronics by 6%, for data processing by 8% and for consumer electronics by 17%.



The growth acceleration of the world economy in the 2006 calendar year did have a slight positive influence on semiconductor market growth. Source: International Monetary Fund; status: September 2006. ¹ Estimated.



The slightly higher growth of the semiconductor market in the 2006 calendar year positively impacted Infineon. Source: WSTS; status: October 2006. ¹ Estimated.

Results of Operations

Reorganization

Our new organizational structure became effective on May 1, 2006, following the legal separation of our memory products business into the stand-alone legal company Qimonda. The results of prior periods have been reclassified to conform to the current period presentation, as well as to facilitate analysis of current and future operating segment information. As a result of the reorganization, certain corporate overhead expenses are no longer apportioned to Qimonda and are instead allocated to Infineon's logic segments.

We operate primarily in three major operating segments, two of which are application focused: Automotive, Industrial & Multi-market, and Communication Solutions; and one of which is product focused: Qimonda. Further, certain of our remaining activities for product lines sold, for which there are no continuing contractual commitments subsequent to the divestiture date, as well as new business activities also meet the FASB Statement of Financial Accounting Standards ("SFAS") No. 131 definition of an operating segment, but do not meet the requirements of a reportable segment as specified in SFAS No. 131. Accordingly, these segments are combined and disclosed in the "Other Operating Segments" category pursuant to SFAS No. 131.

Effective May 1, 2006, with the completion of the Qimonda carve-out, the Other Operating Segments also include revenues and earnings that Infineon's 200-millimeter production facility in Dresden records from the sale of wafers to Qimonda under foundry agreements. The Corporate and Eliminations segment reflects the elimination of these intra-group revenues and earnings.

Net Sales

We generate our revenues primarily from the sale of our semiconductor products and systems solutions. In addition, on average we generated more than 1% of the last three years 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 logic products, which include a wide array of chips and components used in electronic applications ranging from wireless and wireline communication systems, chip cards, automotive electronics and industrial applications.
- > Our memory products, such as dynamic random access memory (DRAM) products, 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.

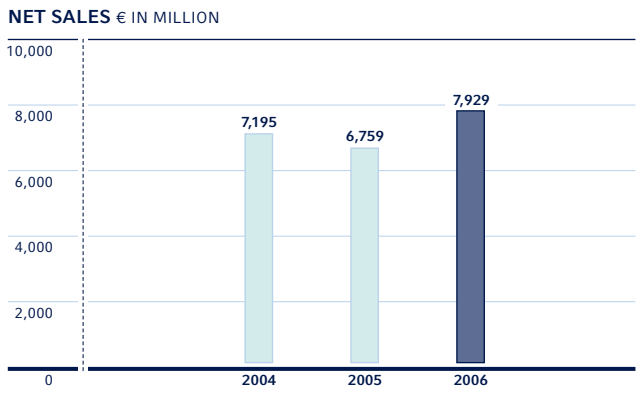
We made the vast majority of our product sales in the 2006 financial year through our direct sales force, with approximately 24% of net sales from our logic segments and approximately 13% of Qimonda's net sales derived from sales made through distributors.

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 Qimonda, resulting from the transfer of technology

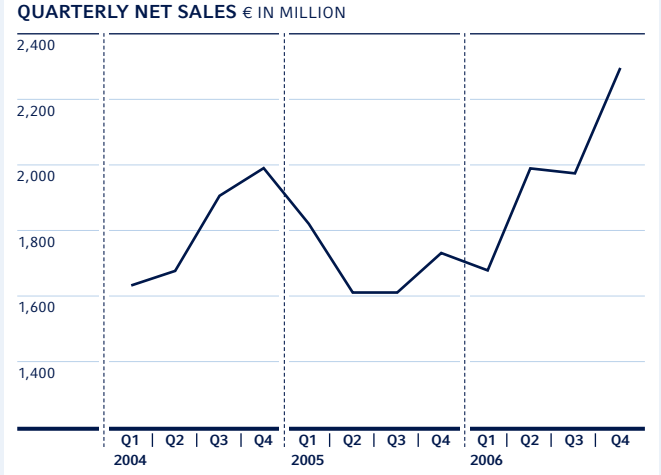
RESULTS OF OPERATIONS AS A PERCENTAGE OF NET SALES

For the years ended September 30 ¹	2004	2005	2006
Net sales	100.0	100.0	100.0
Cost of goods sold	(64.9)	(72.6)	(73.8)
Gross profit	35.1	27.4	26.2
Research and development expenses	(16.9)	(19.1)	(15.8)
Selling, general and administrative expenses	(10.0)	(9.7)	(9.5)
Restructuring charges	(0.2)	(1.2)	(0.3)
Other operating expense, net	(3.6)	(1.4)	(1.4)
Operating income (loss)	4.4	(4.0)	(0.8)
Interest expense, net	(0.6)	(0.1)	(1.2)
Equity in earnings (losses) of associated companies, net	(0.2)	0.9	1.0
Gain on subsidiaries and associated company share issuance, net	0.0	0.0	0.2
Other non-operating income (expense), net	(0.9)	0.4	(0.4)
Minority interests	0.3	0.0	(0.3)
Income (loss) before income taxes	3.0	(2.8)	(1.5)
Income tax expense	(2.1)	(1.8)	(2.0)
Net income (loss)	0.9	(4.6)	(3.5)

¹ Columns may not add due to rounding.



The increase in net sales reflects the higher demand in Qimonda and the Automotive, Industrial & Multimarket segment.



Increase in quarterly net sales reflects the improved business.

to our current and former alliance partners, such as Winbond, Nanya and ProMOS.

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

- > The market prices for our products, particularly our memory 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.

In the 2005 financial year, net sales decreased primarily due to lower demand for products of the wireless business and declining prices for DRAM products. The increase in net sales in the 2006 financial year was mainly driven by higher demand for memory products, especially for graphics, mobile and consumer DRAMs, as well as healthy growth in the Automotive, Industrial & Multimarket segment, particularly in the automotive and industrial power applications businesses. In the 2005 financial year, license income increased primarily due to the settlement reached with ProMOS, whereby €118 million in license income

was recognized. The decrease in license income in the 2006 financial year was mainly driven by the non-recurring license fees from ProMOS recognized in the prior financial year. The strength of major foreign currencies (primarily the U.S. dollar) relative to the euro during the 2006 financial year positively impacted reported net sales, whereas the net sales of the 2004 and 2005 financial year were negatively impacted by the effect of foreign exchange rates. 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 net sales 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. The main effect in the 2006 financial year resulted from the initial consolidation of ALTIS as of December 31, 2005.

For the years ended September 30	2004	2005	2006
Net sales	7,195	6,759	7,929
Changes year-on-year		(6 %)	17 %
Of which:			
License income € in million	76	175	29
% of net sales	1 %	3 %	0 %
Effect of foreign exchange over prior year € in million	(445)	(177)	142
% of net sales	(6 %)	(3 %)	2 %
Impact of acquisitions over prior year € in million	29	2	40
% of net sales	0 %	0 %	0 %

Net Sales by Segment

Automotive, Industrial & Multimarket

In the 2005 financial year, net sales in this segment decreased slightly compared to the 2004 financial year, despite a continued volume increase in the automotive business. The decline was primarily due to strong pricing pressure combined with decreased market volumes in the security and chipcard business. The segment experienced healthy growth in the 2006 financial year as volume grew, particularly for automotive and industrial power applications, more than offsetting ongoing pricing pressure caused by technological developments and competition. We experienced continued strong pricing pressure in the market for chipcard ICs throughout the 2006 financial year.

Communication Solutions

In the 2005 financial year, net sales in the Communication Solutions segment declined year-on-year due to a revenue decrease in the wireless business primarily caused by lower demand for baseband products beginning in the second quarter of the 2005 financial year, as well as continued pricing pressure. This decline could not be offset by the stable net sales trend in the wireline business. The decline in net sales in the 2006 financial year was also caused by a revenue decrease in the wireless business mainly due to a continued decline in demand for baseband products, as well as ongoing pricing pressure. This decline was partly compensated by a strong revenue increase in the wireline business.

Qimonda

Net sales in the 2005 financial year declined compared to the previous year mainly due to pricing pressure, particularly in the first half of the financial year, which could not be compensated by increasing bit shipments and increased revenues from licenses and Flash memory products. In addition, the continued unfavorable U.S. dollar/Euro exchange rate further contributed to the revenue decline. Production volumes increased during the 2005

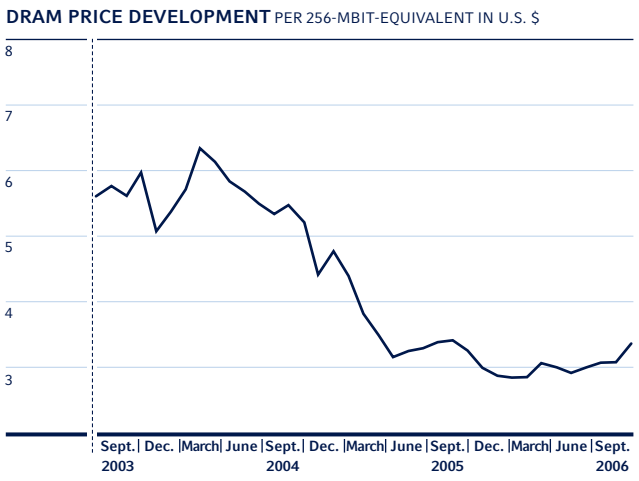
financial year primarily as a result of the ramp-up of our manufacturing joint venture Inotera and the access to additional capacity through our co-operation with Winbond and SMIC. Overall, megabit sales volume increased during the 2005 financial year as a consequence of increasing market demand, particularly for personal computers and system memory. The majority of our memory products sales were based on 256-Mbit DRAMs in the first half of the 2005 financial year and of 512-Mbit DRAMs in the second half of the 2005 financial year, as the market shifted to the next higher-density product generation. Net sales in the 2006 financial year increased compared to the previous year mainly due to increased bit shipments and a favorable U.S. dollar/Euro exchange rate. The higher bit shipments resulted from the ramp-up of our 300-millimeter manufacturing facility in Richmond, the conversion of an increasing share of our capacities to our 90-nanometer technology, our access to additional capacities of our joint venture partners and our foundries as well as the overall demand growth in the DRAM market and our successful diversification in new market segments, particularly with our graphic DRAM products. These positive effects were partly offset by price declines in the DRAM market. The majority of our memory products sales were based in 512-Mbit DRAMs in the 2006 financial year.

DRAM prices were under substantial pressure during the first quarter of our 2006 financial year after which they recovered over the remaining three quarters. Our average per-megabit selling prices for DRAM products (expressed in U.S. dollars) were approximately 20 % less in 2006 financial year compared with the 2005 financial year. The per-megabit selling prices in U.S. dollars at the spot market of our major products with DDR2 interfaces declined sharply at the start of our financial year, declining around 26 % over the first three months. During this quarter, we produced an excess of DDR2 chips because the corresponding DDR2 logic chipsets, which are produced by logic semiconductor manufacturers, were not available in quantities sufficient for PC manufacturers to absorb the supply of DDR2s in

For the years ended September 30	2004		2005		2006	
	€ in million	%	€ in million	%	€ in million	%
Automotive, Industrial & Multimarket	2,540	35	2,516	37	2,839	36
Communication Solutions	1,689	23	1,391	21	1,205	15
Other Operating Segments ¹	16	–	285	4	310	4
Corporate and Eliminations ²	(58)	–	(258)	(4)	(240)	(3)
Subtotal	4,187	58	3,934	58	4,114	52
Qimonda	3,008	42	2,825	42	3,815	48
Total	7,195	100	6,759	100	7,929	100

¹ Includes inter-segment sales of €273 million and €256 million for financial years ended September 30, 2005 and 2006, respectively, from sales of wafers from Infineon's 200-millimeter facility in Dresden to Qimonda under foundry agreements.

² Includes the elimination of inter-segment sales of €273 million and €256 million for financial years ended September 30, 2005 and 2006, respectively, from sales of wafers from Infineon's 200-millimeter facility in Dresden to Qimonda under foundry agreements.



Source: WSTS

the market. A portion of the DDR2 chips that we produced remained unsold and in our inventory until supply of appropriate logic chipsets caught up. Starting January 2006 prices recovered quickly for DDR2 chips, gaining around 26 % in the next three months. After a period of strong and stable pricing until May 2006, DDR2 pricing experienced some modest short-lived price erosion until July 2006 before again rising through to financial year end due to tight market supply. DDR recovered steadily, albeit more slowly from the December 2005 low points, continuing to increase through to the end of our financial year.

Other Operating Segments

The increase of net sales in the 2005 and 2006 financial years resulted mainly from the inter-segment sales of wafers from Infineon’s 200-millimeter facility in Dresden to Qimonda under foundry agreements. Prior to the 2005 financial year the 200-millimeter facility in Dresden was part of the Qimonda segment and related sales were reported within Qimonda.

Net Sales by Region and Customer

Our net sales decreased in the 2005 financial year in all major regions, primarily due to pricing pressure and lower demand for semiconductor products, especially for baseband components in the wireless business in Germany. In the 2006 financial year, our net sales increased in nearly every region, primarily due to higher demand for semiconductor products, in particular for specialty memory products in the consumer electronics and game-console businesses in North America.

The number of customers of our Automotive, Industrial & Multimarket segment remained stable. In the 2006 financial year, the top 20 customers of this segment accounted for approximately 65 % of the segment’s sales. The net sales of this segment increased in all regions, with a particularly strong increase in Asia.

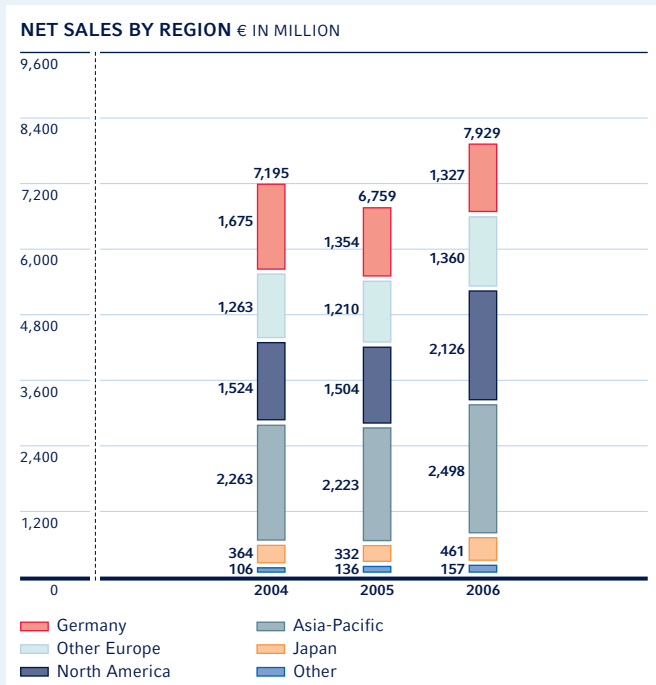
In the Communication Solutions segment, we have seen a further shift of net sales to the Asia-Pacific region. Our top 20 customers in this segment accounted for over 80 % of its net sales. The four largest customers of that segment in the 2006 financial year were BenQ, Ericsson, Nokia and Siemens. In the financial years 2005 and 2006, the wireless business saw net sales drop significantly as a result of the loss in market share experienced by BenQ. The Communication Solutions segment responded to these developments by putting in place much leaner internal structures to reduce fixed costs, and by systematically broadening its customer base. This strategy has made good progress. During financial year 2006, in the face of strong competition, our company won two new major customers, LG Electronics Inc., Seoul, Korea (“LG”), and Samsung.

In the 2006 financial year Qimonda’s top 20 customers accounted for nearly 80 % of its net sales. The net sales of Qimonda improved in all regions, with a particularly strong increase in North America and Japan due to increased net sales of specialty memory products to consumer electronics and game-console manufacturers.

The Siemens group accounted for 13 %, 13 % and 7 % of our net sales in the 2004, 2005 and 2006 financial years, respectively. Sales to the Siemens group are made primarily by our

NET SALES BY REGION AND CUSTOMER

For the years ended September 30	2004		2005		2006	
	€ in million	%	€ in million	%	€ in million	%
Germany	1,675	23	1,354	20	1,327	17
Other Europe	1,263	18	1,210	18	1,360	17
North America	1,524	21	1,504	22	2,126	27
Asia-Pacific	2,263	32	2,223	33	2,498	31
Japan	364	5	332	5	461	6
Other	106	1	136	2	157	2
Total	7,195	100	6,759	100	7,929	100



Increased importance of Asia and North America regions.

logic segments. No other single customer accounted for 10 % or more of our net sales in the 2004, 2005 or 2006 financial years. On April 3, 2006, Siemens disposed of its remaining shareholding in our company. Transactions between us and Siemens subsequent to this date are no longer reflected as related party transactions.

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;
- > 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.

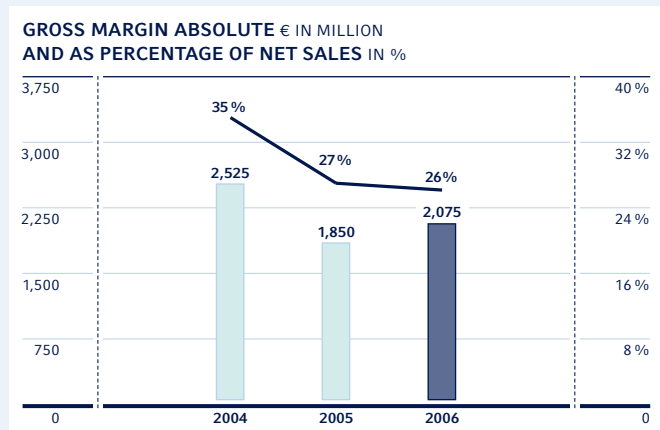
In addition to factors that affect our revenue, our gross margin is impacted by:

- > 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 (consolidated since December 31, 2005) and Inotera. Our purchases from these associated and related companies amounted to €575 million in the 2006 financial year, €615 million in the 2005 financial year and €357 million in the 2004 financial year.

Our gross margin deteriorated in the 2005 financial year, primarily as a result of higher idle capacity costs and strong pricing pressure in most of our operating segments, as well as the unfavorable U.S. dollar/Euro exchange rate, which could not be entirely offset by productivity measures. In the 2006 financial year our gross margin decreased slightly compared to the 2005 financial year due to decreased gross margin of Qimonda, primarily as

For the years ended September 30	2004	2005	2006
Cost of goods sold € in million	4,670	4,909	5,854
Changes year-on-year		5 %	19 %
% of net sales	65 %	73 %	74 %
Gross margin	35 %	27 %	26 %



Reduced gross margin at Qimonda almost compensated by other segments.

a result of lower level of license income and strong pricing pressure for DDR2 memories in the first quarter of the 2006 financial year. This effect was almost entirely offset by the improved gross margin in the Automotive, Industrial & Multimarket and the Communication Solutions segments, particularly due to lower idle costs.

Automotive, Industrial & Multimarket

In the 2005 financial year, gross margin deteriorated as a result of higher idle capacity costs in the first half of the financial year and strong pricing pressure, which could not be fully offset by productivity measures. In the 2006 financial year, our gross margin recovered mainly due to a reduction of idle capacity costs.

Communication Solutions

Gross margin deteriorated in the 2005 financial year mainly due to increased idle capacity costs. In the 2006 financial year, gross margin improved mainly as a result of lower idle capacity costs and the successful implementation of productivity measures, which more than offset the inventory write-downs resulting from the insolvency of BenQ’s German subsidiary.

Qimonda

Gross margin decreased in the 2005 financial year, as the improvements of productivity and reduced manufacturing costs resulting from the conversion to 110-nanometer process technology and our increasing share of 300-millimeter manufacturing could not compensate for the effect of lower average selling prices and the unfavorable U.S. dollar/Euro exchange rate. The gross margin decreased slightly during the 2006 financial year, falling to 20 % from 23 % in the 2005 financial year, primarily as a result of the lower level of license income. Excluding the changes in license income, Qimonda’s gross margin would have remained nearly unchanged. The Qimonda gross margin was under particular pressure early in the 2006 financial year when price pressures were higher, and improved later in the financial year.

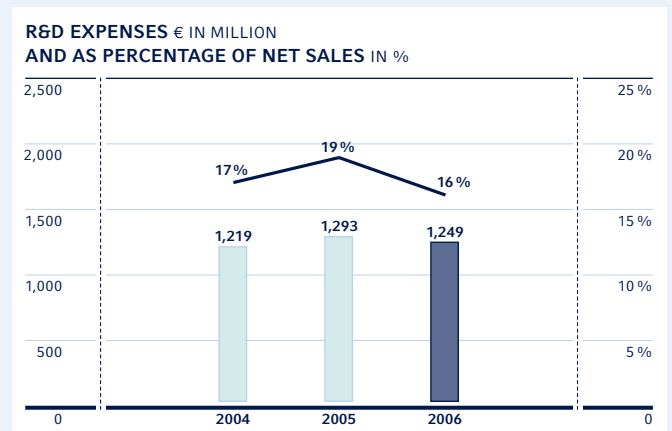
Research and Development (R&D) Expenses

Research and development expenses consist primarily of salaries and fringe benefits for research and development personnel, materials costs, depreciation and maintenance of equipment used in our research and development efforts, and contracted technology development costs. Materials 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 and products with high potential for growth and profitability.

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

For the years ended September 30	2004	2005	2006
Research and development expenses € in million	1,219	1,293	1,249
Changes year-on-year		6 %	(3 %)
% of net sales	17 %	19 %	16 %
Government subsidies € in million	74	50	67
% of net sales	1 %	1 %	1 %



Improved efficiency reduces R&D expenses.

Automotive, Industrial & Multimarket

R&D expenses increased slightly both in absolute terms and as a percentage of sales in the 2005 financial year. The increase took place mainly in the automotive and power businesses. During the 2006 financial year, R&D expenses remained approximately on the same level as in 2005 financial year in absolute terms and slightly decreased as a percentage of sales.

Communication Solutions

R&D expenses in the 2005 financial year remained relatively stable in absolute terms and increased relative to sales compared to the 2004 financial year. The high level of R&D expenses was maintained in the first half of the 2005 financial year, with a focus on software and solution activities for third-generation mobile phone semiconductors as well as for broadband semiconductor solutions. In the second half of the 2005 financial year, R&D expenses were reduced in absolute terms, reflecting the successful implementation of efficiency programs initiated in the second quarter of the 2005 financial year. In the 2006 financial year, R&D expenses further declined in absolute terms and remained stable as a percentage of net sales compared to the 2005 financial year as the effect of previously implemented efficiency programs was realized during the 2006 financial year.

Qimonda

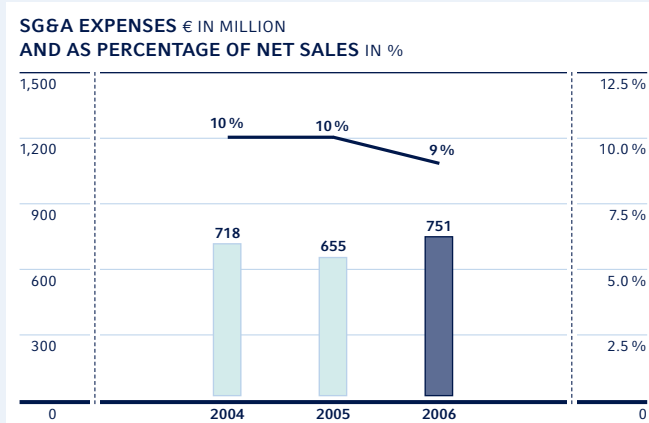
In the 2005 financial year, R&D expenses increased in absolute terms due to increased spending on the acceleration of the development of next-generation memory technologies and the broadening of the overall memory portfolio. In the 2006 financial year, R&D expenses increased again in absolute terms due to our effort to strengthen our development capabilities with respect to next-generation memory technologies and the further diversification of our portfolio of memory products. They decreased as a percentage of net sales due to increased net sales.

Selling, General and Administrative (SG&A) Expenses

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

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

For the years ended September 30	2004	2005	2006
Selling, general and administrative expenses			
€ in million	718	655	751
Changes year-on-year		(9%)	15%
% of net sales	10%	10%	9%



Increased SG&A expenses mainly caused by the insolvency of BenQ's German subsidiary, Qimonda carve-out and stock-based compensation.

Selling and administrative expenses increased primarily due to charges of €28 million incurred in connection with the insolvency of BenQ's German subsidiary, expenses of €16 million related to the Qimonda formation, as well as stock-based compensation costs of €12 million.

Other Items Affecting Earnings

For the years ended September 30	2004	2005	2006
Restructuring charges € in million	17	78	23
% of net sales	0%	1%	0%
Other operating expense, net € in million	257	92	108
% of net sales	4%	1%	1%
Equity in (losses) earnings of associated companies, net € in million	(14)	57	78
% of net sales	(0%)	1%	1%
Gain on subsidiaries and associated companies share issuance, net € in million	2	–	19
% of net sales	0%	0%	0%
Other non-operating (expense) income, net € in million	(64)	26	(33)
% of net sales	(1%)	0%	(0%)

Restructuring Charges

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 2005 financial year, we continued our restructuring and cost-saving efforts aimed at reducing costs, including downsizing our workforce and consolidating certain functions and operations. We agreed upon plans to terminate employees, primarily in connection with the close down of fiber optics operations in Germany and the United States, as well as measures taken to restructure our chip manufacturing in the front-end area within the manufacturing cluster Perlach, Regensburg and Villach. Production activities at Munich-Perlach will be transferred principally to Regensburg and, to a lesser extent, to Villach. In the 2006 financial year, we continued our restructuring measures to downsize the workforce at ALTIS and our chip card back-end activities in order to maintain competitiveness and reduce cost. As part of the restructurings, it is expected that a total of 450 employees will be terminated.

Other Operating Expense, net

Other operating expense, net in the 2004 financial year related principally to charges from our settlement of 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 2005 financial year, other operating expense included a net charge of €96 million resulting primarily from the reorganization of certain communication businesses and goodwill and other intangible assets impairment charges. In the 2006 financial year, other operating expenses consisted mainly of goodwill and intangible assets impairment charges of €38 million, antitrust related charges of €23 million, the settlement of Tessera litigation of €37 million, and a loss of €12 million from our sale of Qimonda shares due to the exercise of the underwriters' over-allotment option in connection with the initial public offering of Qimonda.

Equity in (Losses) Earnings of Associated Companies

Our principal associated company is currently Inotera, as ALTIS has been fully consolidated as of December 31, 2005. Inotera is a DRAM manufacturer and is reflected in the results of Qimonda; our equity in its earnings has been sensitive to fluctuations in the price of DRAM and is reflected in the results of Qimonda.

Start-up losses at Inotera during the ramp-up phase of production contributed to the losses incurred in the 2004 financial year. In the 2005 and 2006 financial years, Inotera contributed the majority of our equity in earnings from associated companies, reflecting the start of volume production by that joint venture in the 2005 financial year.

Gain on Subsidiaries and Associated Company Share Issuance, net

In August 2006, Qimonda successfully completed an initial public offering on the New York Stock Exchange of 42 million new ordinary shares, together with 6.3 million ordinary shares from Infineon in an over-allotment option, at a price of \$13 per share. We realized a non-operating loss of €53 million from the dilution of our interest in Qimonda following its initial public offering.

In March and May 2006, our joint venture Inotera successfully completed an initial public offering on the Taiwanese Stock Exchange of 200 million ordinary shares and a public offering on the Luxembourg Stock Exchange of 40 million global depositary shares (representing 400 million common shares), each at an issuance price of NT\$33 per ordinary share. As a result of these transactions, we recognized a non-operating gain of €72 million.

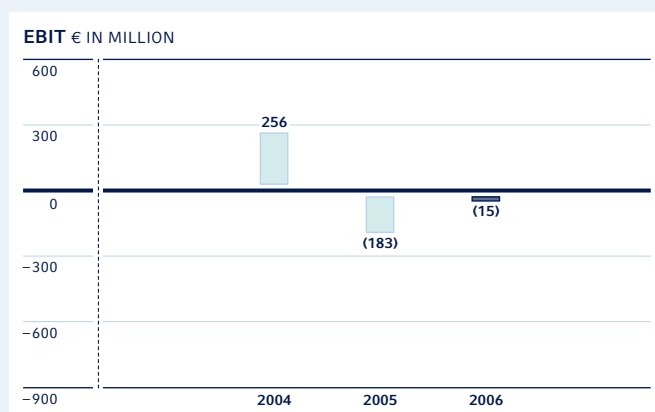
Other Non-Operating (Expense) Income, net

Other non-operating income and expense consists of various items in different periods not directly related to our principal operations, including gains and losses on sales of marketable securities. Other non-operating expense, net in the 2004 financial year mainly consisted of €65 million of investment-related impairment charges. In the 2005 financial year, non-operating income, net included €40 million related to net gains from foreign currency derivatives and foreign currency transactions and a gain of €13 million realized on the sale of our venture capital activities, partially offset by investment-related impairment charges of €29 million. In the 2006 financial year, the non-operating expenses consisted mainly of €31 million related to net losses from foreign currency derivatives and foreign currency transactions and investment-related impairment charges of €13 million.

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 operating segments. EBIT is determined from the consolidated statements of operations as follows:

For the years ended Sep. 30 € in million	2004	2005	2006
Net income (loss)	61	(312)	(268)
Add: Income tax expense	154	120	161
Interest expense, net	41	9	92
EBIT	256	(183)	(15)



Special effects reduce positive development of operating result.

The EBIT results reflect the combined effects of the following EBIT movements of our reporting segments:

Automotive, Industrial & Multimarket

The EBIT decline in the 2005 financial year resulted primarily from the deterioration of the gross margin. The EBIT improvement in the 2006 financial year was mainly due to higher sales volumes and improved gross margin, partially offset by continued strong price pressure especially in the automotive and chip-card businesses. In the 2005 and 2006 financial years, EBIT was negatively impacted by costs related to product transfers in connection with the planned phase-out of production at Munich-Perlach and costs incurred in connection with our new production site in Kulim, Malaysia.

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

For the years ended Sep. 30 € in million	2004	2005	2006
Automotive, Industrial & Multimarket	252	134	246
Communication Solutions	(44)	(295)	(231)
Other Operating Segments	(75)	4	4
Corporate and Eliminations	(39)	(137)	(236)
Subtotal	94	(294)	(217)
Qimonda ¹	162	111	202
Total	256	(183)	(15)

¹ EBIT results of Qimonda for the period following its IPO are reported net of minority interest results.

Communication Solutions

The EBIT decrease in the 2005 financial year resulted mainly from charges in connection with the reorganization of certain communication businesses and impairment charges aggregating €96 million, as well as a decline in gross margin. In the 2006 financial year, EBIT was negatively impacted by charges aggregating €91 million, primarily in connection with the insolvency of BenQ's German subsidiary. Despite these charges, EBIT improved in the 2006 financial year mainly due to lower idle capacity costs and the implementation of cost reduction measures.

Qimonda

The EBIT decline in the 2005 financial year resulted primarily from a decline of average selling prices for DRAM products and the weak U.S. dollar/Euro exchange rate, as well as the increase in R&D expenses resulting from the acceleration of our technology development and the broadening of our product portfolio, which was not entirely offset by productivity improvements and increasing license revenue. In the 2006 financial year, EBIT increased primarily due to sales volume growth, higher bit shipments and a favorable U.S dollar/Euro exchange rate compared to the 2005 financial year.

Other Operating Segments

EBIT in the 2005 financial year was positively impacted by a gain of €13 million realized on the sale of our venture capital activities, which were impaired in the 2004 financial year. The EBIT in the 2006 financial year remained unchanged compared to the 2005 financial year.

Corporate and Elimination

EBIT deterioration in the 2005 financial year resulted primarily from restructuring charges of €78 million in connection with the planned phase-out of production at our Munich-Perlach facility and the restructuring of our fiber optics business. The EBIT decline in the 2006 financial year was mainly due to aggregate charges of approximately €80 million incurred in connection with the formation of Qimonda, the dilution of our interest in Qimonda following its IPO, as well as our sale of Qimonda shares upon exercise of the underwriters' over-allotment option.

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 is net of interest capitalized on manufacturing facilities under construction.

For the years ended September 30	2004	2005	2006
Interest expense, net € in million	(41)	(9)	(92)
% of net sales	(1%)	0%	(1%)

Interest expense in the 2004, 2005 and 2006 financial years relates principally to the convertible bonds that we issued in February 2002 and in June 2003. In addition, interest expense in the 2004 financial year included €21 million, paid upon redemption of the other investors' ownership interests in the Infineon Technologies SC300 GmbH & Co. OHG ("SC300") venture in Dresden. These effects were partially reduced in the 2004 and 2005 financial years as a result of the redemption of a portion of our convertible bonds in 2004 and increased interest capitalization related to facilities under construction, as well as interest income from financial derivatives. The increase of the interest expense, net in the 2006 financial year is mainly due to the drawdown of \$345 million under our \$400/€400 million syndicated credit facility to finance the expansion of our Richmond manufacturing facility and a reduction in income from interest rate swaps resulting from increased variable interest rates, and to a lesser extent, interest on outstanding tax obligations and a reduction in capitalized interest.

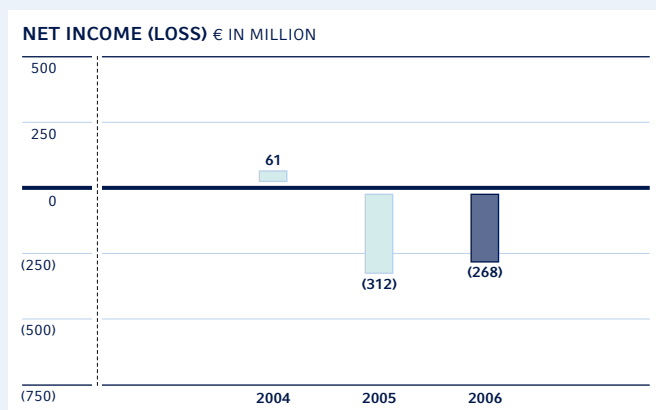
Income Taxes

For the years ended September 30	2004	2005	2006
Income tax expense € in million	(154)	(120)	(161)
% of net sales	(2%)	(2%)	(2%)
Effective tax rate	(72%)	(63%)	(150%)

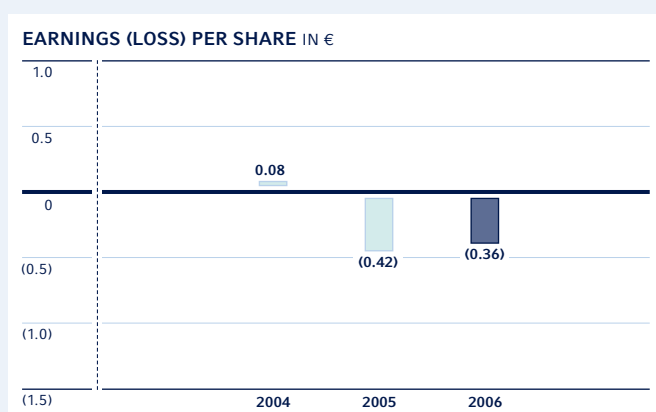
Pursuant to U.S. GAAP, deferred tax assets in tax jurisdictions that have a three-year cumulative loss are subject to a valuation allowance excluding the impact of forecasted future taxable income. In the 2004 financial year, our effective tax rate increased because we recorded additional valuation allowances of €54 million related to tax jurisdictions that continue to have a three-year cumulative loss, and also had more non-deductible expenditures. In the 2005 and 2006 financial years we continued to have a three-year cumulative loss in certain tax jurisdictions and we recorded increases to the valuation allowance of €192 million and €292 million, respectively. 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)

In the 2004 financial year, we were profitable due to sales volume growth, manufacturing efficiencies and cost reduction efforts, although the impact was reduced through increased charges for impairments, antitrust-related matters and tax expense. In the 2005 financial year, the net loss incurred resulted primarily from the combination of lower revenues and gross margin, long-term asset impairments, restructuring measures and tax expense. In the 2006 financial year, the net loss incurred was primarily due to charges resulting from the insolvency of BenQ's German subsidiary, the initial public offering of Qimonda, as well as the settlement of litigation. In addition, in the 2006 financial year our company began to recognize the fair value of employee stock options in earnings, which further contributed to the net loss incurred.



Special effects combined with higher tax expenses lead to an only slight improvement of the net loss.



Financial Condition

For the years ended Sep. 30 in million	2005	2006	% Change year-on-year
Current assets	4,574	5,681	24
Non-current assets	5,710	5,504	(4)
Total assets	10,284	11,185	9
Current liabilities	2,382	3,305	39
Non-current liabilities	2,192	1,725	(21)
Total liabilities	4,574	5,030	10
Minority Interests	81	840	+++
Shareholders' equity	5,629	5,315	(6)

As of September 30, 2006, our total assets and current assets increased in comparison to the prior year due to increased cash and cash equivalents. The increase of cash and cash equivalents resulted from the net proceeds of €464 million from the initial

public offering of Qimonda and the sale of Qimonda shares upon exercise of the underwriters' over-allotment option, as well as proceeds from a drawdown under our \$400/€400 million syndicated credit facility in the amount of \$345 million to finance the expansion of our Richmond manufacturing facility.

Non-current assets decreased slightly at the end of the 2006 financial year as capital expenditures mostly offset depreciation, amortization and impairment charges during the year.

Total liabilities increased as of the end of the 2006 financial year, mainly due to the drawdown under the \$400/€400 million syndicated credit facility in the amount of \$345 million to finance the expansion of our Richmond manufacturing facility. The increase in current liabilities resulted primarily from the reclassification of €638 million related to subordinated convertible notes due 2007 from non current liabilities into current liabilities. The decrease of non-current liabilities due to that reclassification was partly offset by the \$345 million drawdown under the syndicated credit facility. The increase of the minority interests resulted primarily from the initial public offering of Qimonda and the initial consolidation of ALTIS as of December 31, 2005.

Financial Ratios

In the 2006 financial year our equity ratio decreased principally due to the net loss during the year. At September 30, 2006, our equity ratio was 48 %, a 7 % decrease from September 30, 2005.

The return on equity amounted to negative 5 % and the return on assets amounted to negative 3 % due to the net loss in the 2005 financial year, compared to positive 1 % for both financial ratios in the 2004 financial year. In the 2006 financial year, the return on equity remained unchanged at negative 5 % and the return on assets improved to negative 2 % due to a smaller net loss and increased total assets compared to the 2005 financial year.

The equity-to-fixed-assets ratio decreased to 150 % in the 2005 financial year from 167 % in the prior year as a result of the net loss and capital expenditures which exceeded depreciation expense during the year. In the 2006 financial year, the equity-to-fixed-assets ratio further decreased to 141 % mainly as a result of the net loss and nearly unchanged fixed assets.

The decrease of the debt-to-equity ratio to 30 %, compared to 33 % in the 2004 financial year, was mainly attributable to the repayment of the €450 million loan entered into in connection with the build-out of our plant in Dresden during the 2005 financial year. In the 2006 financial year, the debt-to-equity ratio increased to 38 % primarily due to the drawdown under the \$400/€400 million syndicated credit facility in the amount of \$345 million to finance the expansion of our Richmond manufacturing facility.

FINANCIAL RATIOS

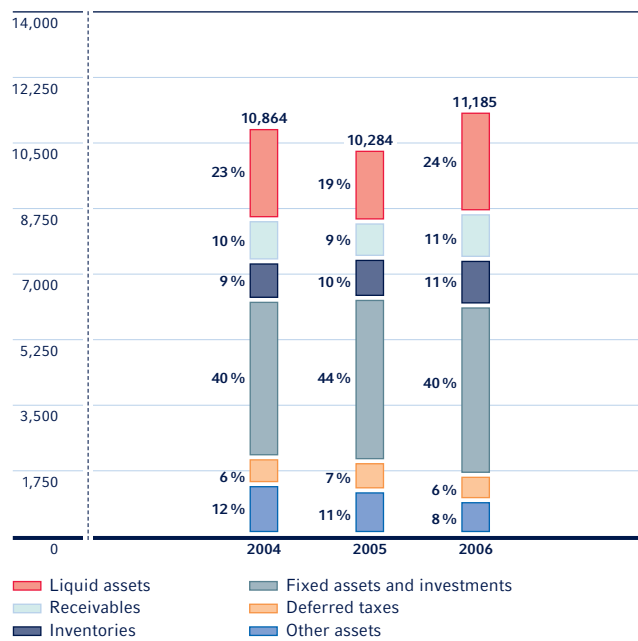
For the years ended September 30 in %	2004	2005	2006
Non-current asset intensity ¹	51	56	49
Current asset intensity ²	49	44	51
Degree of wear of fixed assets ³	67	67	72
Depreciation rate of fixed assets ⁴	11	11	10
Inventory intensity ⁵	9	10	11
Inventory turnover ⁶	7.5	6.8	7.1
Inventory turnover in days ⁷	48	53	50
Days sales outstanding ⁸	48	53	50
Equity ratio ⁹	55	55	48
Return on equity ¹⁰	1	(5)	(5)
Return on assets ¹¹	1	(3)	(2)
Equity-to-fixed-assets ratio ¹²	167	150	141
Debt-to-equity ratio ¹³	33	30	38

The aforementioned ratios of the financial condition are calculated as follows:

- 1 Non-current asset intensity = non-current assets/total assets
- 2 Current asset intensity = current assets/total assets
- 3 Degree of wear of fixed assets = accumulated depreciation on fixed assets/historical costs of fixed assets at the end of the financial year
- 4 Depreciation rate of fixed assets = annual depreciation of fixed assets/historical costs of fixed assets at the end of the financial year
- 5 Inventory intensity = inventory/total assets
- 6 Inventory turnover = annual net sales/average inventory
- 7 Inventory turnover in days = average inventory x 360 days/annual net sales
- 8 Days sales outstanding = average accounts receivable x 360 days/annual net sales
- 9 Equity ratio = shareholders' equity/total assets
- 10 Return on equity = net income (loss) for the year/average equity
- 11 Return on assets = net income (loss) for the year/average total assets
- 12 Equity-to-fixed-assets ratio = equity/property, plant and equipment
- 13 Debt-to-equity ratio = (short-term debt + long-term debt)/equity

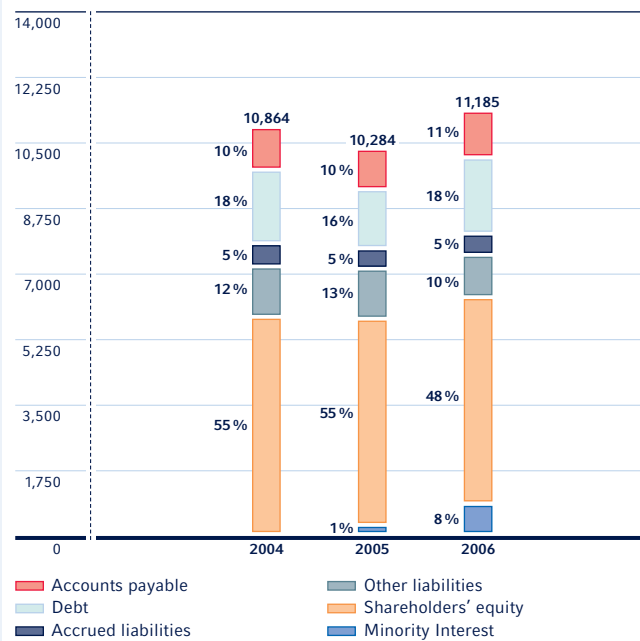
The average of a balance sheet position is calculated as the arithmetic average of the amount as of the balance sheet date of the current and the prior years.

ASSETS € IN MILLION



Liquid assets increased due to net proceeds from Qimonda IPO.

LIABILITIES AND EQUITY € IN MILLION



Issuance of long-term debt mainly for expansion of Richmond facility leads to an increase of financial debt.

Liquidity

Cash Flow

For the years ended September 30 € in million	2004	2005	2006
Net cash provided by operating activities	1,857	1,039	974
Net cash used in investing activities	(1,809)	(238)	(824)
Net cash provided by (used in) financing activities	(402)	(266)	762
Cash and cash equivalents at year end	608	1,148	2,040

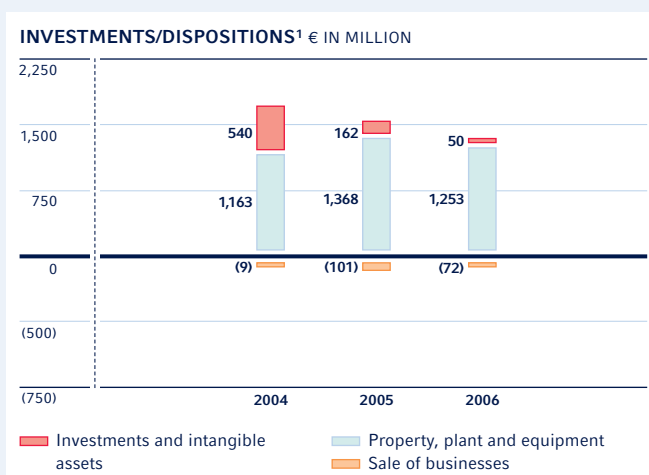
Our consolidated statement of cash flows shows the sources and uses of cash during the reported periods. It is of key importance for the evaluation of our financial position.

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 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 2006 financial year resulted mainly from the net loss of €268 million, which is net of non cash charges for depreciation of €1,405 million, impairment charges of €57 million and equity in earnings of associated companies of €78 million. Cash provided by operating activities was positively impacted by an increase of trade accounts payable, accrued liabilities and other current liabilities of €359 million, and negatively impacted by an increase in inventories and trade accounts receivable of €479 million.

Cash used in investing activities in the 2006 financial year mainly reflects capital expenditures of €1,253 million, principally to equip our manufacturing facilities in Richmond and Kulim, as well as net proceeds from net sales of marketable securities of €238 million and cash used for purchases of intangible assets of €44 million.

Cash provided by financing activities in the 2006 financial year principally relates to the net proceeds of €406 million from the initial public offering of Qimonda and proceeds from the issuance of long-term debt of €400 million, in particular from a drawdown of \$345 million under our \$400/€400 million syndicated credit facility to finance the expansion of our Richmond manufacturing facility.



Increase in manufacturing capacity of Richmond and Kulim leads to capital spending for property, plant and equipment.

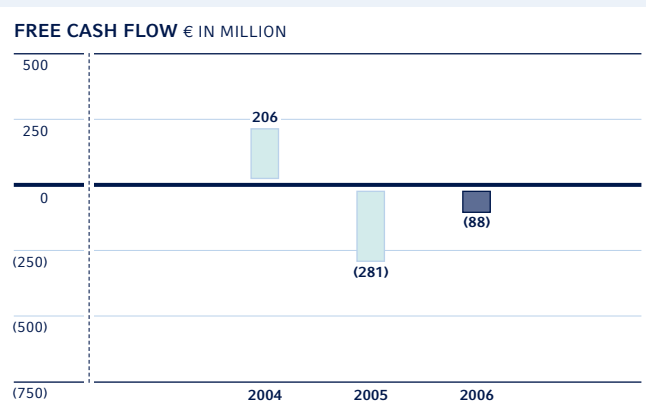
¹ Without marketable securities.

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 consolidated statements of cash flows:

For the years ended Sep. 30 € in million	2004	2005	2006
Net cash provided by operating activities	1,857	1,039	974
Net cash used in investing activities ¹	(1,809)	(238)	(824)
Purchases (sales) of marketable securities, net	158	(1,082)	(238)
Free cash flow	206	(281)	(88)

1 In the 2006 financial year the amount is net of €119 million cash increase from the initial consolidation of ALTIS.



The net balance of purchases and sales of securities leads to negative free cash flow.

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.

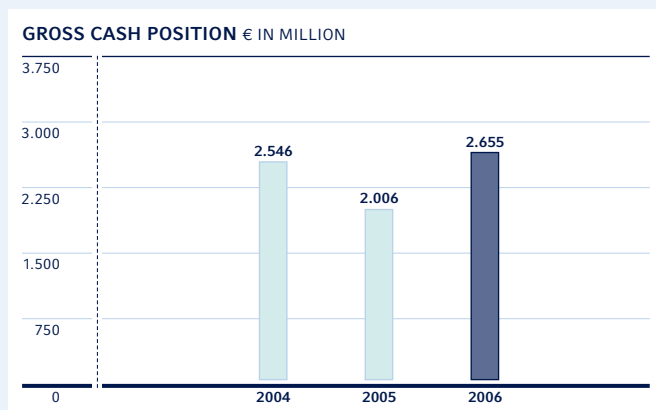
Our gross cash position – representing cash and cash equivalents, plus marketable securities – increased to €2,655 million at September 30, 2006, compared with €2,006 million at the prior year end. The increase was mainly due to the net proceeds of €464 million from the initial public offering of Qimonda and the sale of Qimonda shares upon exercise of the underwriters' over-allotment option.

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 business operations. The total outstanding convertible notes as of September 30, 2006 amounted to €1,340 million.

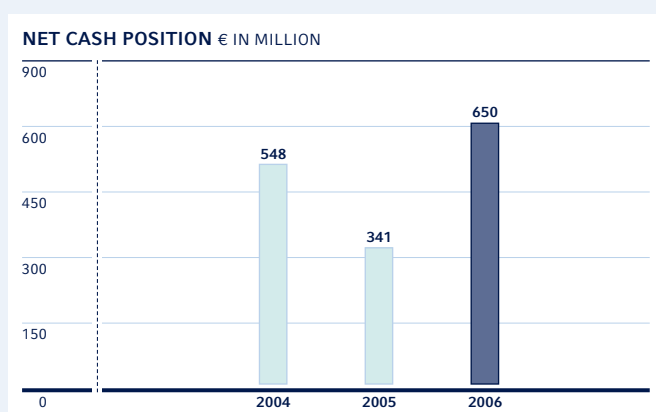
On June 5, 2003, we issued €700 million in subordinated convertible notes due 2010 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 68.4 million ordinary shares of our company, at a conversion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

As of September 30, 2006 € 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
Cash and cash equivalents	2,040	2,040	–	–	–	–	–
Marketable securities	615	615	–	–	–	–	–
Gross cash position	2,655	2,655	–	–	–	–	–
Less:							
Long-term debt	1,208	–	157	181	744	55	71
Short-term debt and current maturities	797	797	–	–	–	–	–
Total financial debt	2,005	797	157	181	744	55	71
Net cash position	650	1,858	–157	–181	–744	–55	–71



Gross cash position increased due to net proceeds from Qimonda IPO.



Net cash position reflects additional cash inflow from Qimonda IPO.

€35.43 per share through maturity. During the 2004 financial year we redeemed €360 million of our convertible notes due 2007. As of September 30, 2006 the outstanding amount was €640 million. These convertible notes are due on February 6, 2007 and we expect to redeem the notes at their principal outstanding amount using available cash to the extent that they have not previously been redeemed, converted or purchased and cancelled.

Our net cash position – meaning cash and cash equivalents, plus marketable securities, less total financial debt – increased by €309 million to €650 million at September 30, 2006, compared with €341 million at September 30, 2005, principally due to the net proceeds of €464 million from the initial public offering of Qimonda and the sale of Qimonda shares upon exercise of the underwriters' over-allotment option.

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

Capital Requirements

We require capital in our 2007 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 flows generated from operations;
- > Cash on hand and securities we can sell; and
- > Available credit facilities.

As of September 30, 2006, we require funds for the 2007 financial year aggregating €2,138 million, consisting of €797 million for short-term debt payments and €1,341 million for commitments. In addition, we may need up to €162 million for currently known contingencies. We also plan to invest up to an additional €900 million in capital expenditures that have not been otherwise committed. We have a gross cash position of €2,655 million as of September 30, 2006, and also the ability to draw funds from available credit facilities of €903 million.

As of September 30, 2006, we had debt of €797 million scheduled to become due within one year.

Commitments and Contingencies

As of September 30, 2006 ^{1,2} € 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
Contractual commitments:							
Operating lease payments	959	104	91	85	66	64	549
Unconditional purchase commitments	1,396	1,171	153	25	15	11	21
Other commitments	132	66	66	–	–	–	–
Total commitments	2,487	1,341	310	110	81	75	570
Other contingencies:							
Guarantees ³	198	6	20	12	–	14	146
Contingent government grants ⁴	548	156	129	36	55	27	145
Total contingencies	746	162	149	48	55	41	291

The above table should be read together with Note 33 to our consolidated financial statements for the year ended September 30, 2006.

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, 2006. Purchases under these agreements aggregated €1,204 million for the year ended September 30, 2006.

3 Guarantees are mainly issued for the payment of import duties, rentals of buildings and contingent obligations related to government grants received.

4 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.

Off-Balance Sheet Arrangements

We issue guarantees in the normal course of business, mainly for the payment of import duties, rentals of buildings and contingent obligations related to government grants received. As of September 30, 2006, the undiscounted amount of potential future payments for guarantees was €198 million.

Capital Expenditures

For the years ended September 30, € in million	2004	2005	2006
Non-memory businesses ¹	393	442	567
Qimonda	770	926	686
Total	1,163	1,368	1,253

1 Includes elimination of inter-segment transfers of €23 million, €149 million and €37 million for financial years ended September 30, 2004, 2005 and 2006, respectively.

Depending on our business situation we expect to invest between €1,200 million and €1,400 million in capital expenditures

in the 2007 financial year, largely for our manufacturing facilities in Richmond, Virginia, and Kulim, Malaysia. We also constantly improve productivity and upgrade technology at existing facilities, especially in Dresden, Germany. As of September 30, 2006, €514 million of this amount was committed and included in unconditional purchase commitments. Due to the lead times between ordering and delivery of equipment, a substantial amount of capital expenditures typically is committed well in advance. Approximately 50 % to 60 % of these expected capital expenditures will be made in the front-end and back-end facilities of Qimonda.

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 €1,578 million, of which €903 million remained available at September 30, 2006, comprise the following:

CREDIT FACILITIES € IN MILLION			As of September 30, 2006		
Term	Nature of financial institution commitment	Purpose/intended use	Aggregate facility	Drawn	Available
Short-term	firm commitment	working capital, guarantees	95	51	44
Short-term	no firm commitment	cash management, working capital	309	–	309
Long-term	firm commitment	working capital	823	273	550
Long-term ¹	firm commitment	project finance	351	351	–
Total			1,578	675	903

1 Including current maturities.

In September 2004 we executed a \$400/€400 million syndicated credit facility with a five-year term. The facility consisted of two tranches: Tranche A is a \$400 million term loan intended to finance the expansion of our Richmond, Virginia, manufacturing facility. In January 2006 we drew \$345 million under this Tranche A, the amount being equal to the maximum outstanding amount permitted at September 30, 2006. The loan will decrease on the basis of a repayment schedule that foresees equal installments, falling due in March and September of each year. Tranche B is a €400 million multicurrency revolving facility to be used for general corporate purposes. In connection with the arrangement of the Qimonda credit facility described below we voluntarily cancelled an amount of €100 million in August 2006 so that €300 million remains available to us. At September 30, 2006, no amounts were outstanding under this Tranche B. The facility has customary financial covenants, and drawings bear interest at market-related rates that are linked to financial performance. The lenders of this credit facility have been granted a negative pledge relating to our future financial indebtedness with certain permitted encumbrances.

In August 2006, Qimonda executed a €250 million syndicated multicurrency revolving loan facility with a three-year term, which may be extended for one additional year at the option of the lenders at the end of the facility's first year of operation. At September 30, 2006, no amounts were outstanding under this facility.

At September 30, 2006, 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 on a timely basis or at all. We can provide no assurance that we will be able to obtain additional financing for our research and development, working capital or investment requirements or that any such financing, if available, will be on terms favorable to us.

Taking into consideration the financial resources available to us, including our internally generated funds and currently available banking facilities, we believe that we will be in a position to fund our capital requirements in the 2007 financial year.

Pension Plan Funding

Our projected benefit obligation, which considers future compensation increases, amounted to €518 million at September 30, 2006, compared to €477 million at September 30, 2005. The fair value of plan assets as of September 30, 2006 was €320 million, compared to €243 million as of September 30, 2005.

The actual return on plan assets between the last measurement dates amounted to 6.7% or €14 million for domestic (German) plans and 5.7% or €2 million for foreign plans, compared to the expected return on plan assets for that period of 6.5% for domestic plans and 6.9% for foreign plans. We have estimated the return on plan assets for the next financial year to be 6.1% or €18 million for domestic plans and 6.9% or €3 million for foreign plans.

At September 30, 2005 and 2006, the combined funding status of our pension plans reflected an underfunding of €234 million and €198 million, respectively. We intend to make contributions to our pension plans during the year ending September 30, 2007, in a similar range of those made during the year ended September 30, 2006.

Our investment approach with respect to the pension plans involves employing a sufficient level of flexibility to capture investment opportunities as they occur, while maintaining reasonable parameters to ensure that prudence and care are exercised in the execution of the investment program. The pension plans' assets are invested with several investment managers. The plans employ a mix of active and passive investment management programs. Considering the duration of the underlying liabilities, a portfolio of investments of plan assets in equity securities, debt securities and other assets is targeted to maximize the long-term return on plan assets for a given level of risk. Investment risk is monitored on an ongoing basis through periodic portfolio reviews, meetings with investment managers and liability measurements. Investment policies and strategies are periodically reviewed to ensure the objectives of the plans are met considering any changes in benefit plan design, market conditions or other material items.

Our asset allocation targets for pension plan assets are based on our assessment of business and financial conditions, demographic and actuarial data, funding characteristics, related risk factors, market sensitivity analyses and other relevant factors. The overall allocation is expected to help protect the plans' level of funding while generating sufficiently stable real returns (i.e., net of inflation) to meet current and future benefit payment needs. Due to active portfolio management, the asset allocation may differ from the target allocation up to certain limits. As a matter of policy, our pension plans do not invest in Infineon or Qimonda shares.

Financial Instruments

We periodically enter into derivatives, including foreign currency forward and option contracts as well as interest rate swap agreements. The objective of these transactions is to reduce the impact of interest rate and exchange rate fluctuations on our foreign currency denominated net future cash flows. We do not enter into derivatives for trading or speculative purposes.

Employees and Campeon

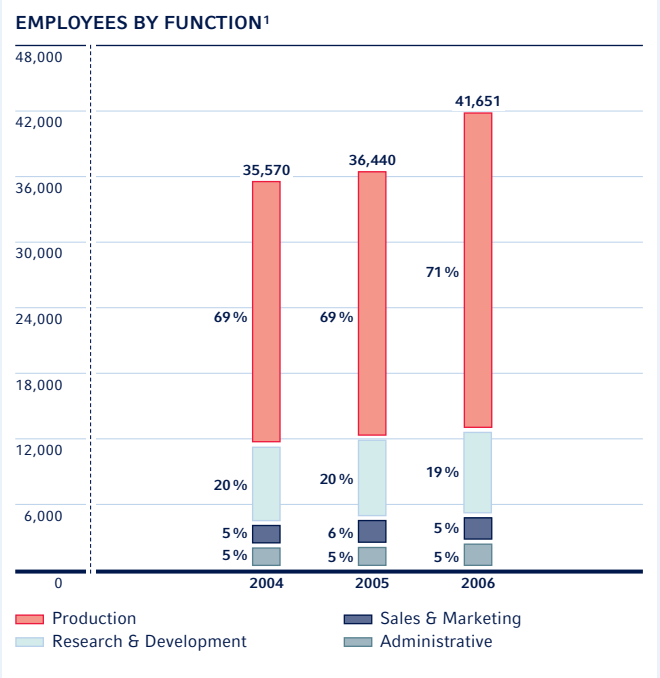
Employees

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	2004	2005	2006
Function:			
Production	24,540	25,114	29,641
Research & Development	7,160	7,401	7,745
Sales & Marketing	1,948	2,016	2,101
Administrative	1,922	1,909	2,164
Total	35,570	36,440	41,651
Region:			
Germany	16,387	16,119	15,736
Europe	5,631	5,482	7,244
North America	2,982	3,193	3,295
Asia-Pacific	10,340	11,451	15,148
Japan	133	158	187
Other	97	37	41
Total	35,570	36,440	41,651

Of the total workforce, 11,058, 9,606 and 11,802 as of September 30, 2004, 2005 and 2006, respectively, were employees of Qimonda.

In the 2005 and 2006 financial years, our headcount increased principally due to the expansion of manufacturing capacities in Malaysia and China. The increase of our headcount in Europe during the 2006 financial year resulted mainly from the first-time consolidation of ALTIS as of December 31, 2005.



Increase in production capacity leads to an increase in headcount. 1 Columns may not add up due to rounding.

Campeon

We have entered into a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG ("MoTo") to lease an office complex constructed by MoTo south of Munich, Germany. The office complex, called Campeon, has enabled us to centralize most of our Munich-area employees in one central physical working environment. MoTo was responsible for the construction, which was 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. We occupied Campeon in October 2005 and completed the gradual move of our employees to this new location in the 2006 financial year.

Risk Report

Introduction

Like no other business, the semiconductor industry is characterized by periods of growth which 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 achieve and sustain market leadership as well as the sector's rapid pace of technological change. These risks are, however, often accompanied by substantially greater opportunities.

Infineon Risk and Opportunity Management System

Given the volatility of the business cycle in the semiconductor industry it is very important that the risk and opportunity management policies are geared towards the goal of resilient profitable growth. The ability to quickly react to changing market developments is therefore crucial. To this end we have established a risk and opportunity management system which allows us 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 management process and the risk and opportunity reporting process respectively. 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.

We consider risk and opportunity management to be a foundation of our business activities and an integral part of related processes. It commences at the level of strategic planning and continues through the development, the manufacturing and sales operations, including the processing of receivables. As an extension of the forecasting processes, 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 impact the business, the system is also used to prioritize and implement activities to mitigate or reduce our risk and to enhance opportunities.

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, we have established a quantitative risk analysis process for our investing and research and development activities in order to provide greater transparency of risks and prioritize measures designed to enhance the probabilities of success of these activities. Furthermore, this 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 ensure 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. 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 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 is evaluated by the external auditors as part of the annual audit process. The external auditors confirm that the Management Board has fulfilled its obligation according to paragraph 91 section 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 and Environmental Risks

As a global operating Company our business could suffer from periodic downturns. Furthermore, substantial changes in regional business environments around the globe may also have adverse effects 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. Substantially 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 effect on our business and results of operations. It cannot be excluded that regional crises like the bird flu or the SARS epidemic will not have any negative effect 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 crises as the dependencies are generally reduced.

Risks related to our operations

Effective May 1, 2006, Qimonda the former 100% owned subsidiary of Infineon Technologies AG, took over the activities of the memory products segment (MP). The initial public offering of Qimonda was completed on August 9, 2006. Infineon still owns the majority of this company.

The volatility of DRAM-Memory prices remains the most important risk in the Qimonda segment. In the past financial year the market price of our main product, the 512 Mbit DDR2 SDRAM varied between \$6.57 and \$3.71 (source: DRAM eXchange, 512 Mbit DDR2 533 Mhz Spot average). The continuous expansion of Qimonda's product portfolio through the introduction of new memory products and graphic memories could also pose substantial future risks.

Within the Logic segments of our business, Automotive, Industrial & Multimarket as well as Communication Solutions, we see comparatively less volatility than in the Qimonda segment but nonetheless substantial volume risks. The quick pace of technological change coupled with the possibility of delays in the introduction of new products in the market can have a significant effect on our production volumes which may in turn influence the relationships with our major customers. Price pressure for individual products within the competitive market environment may further influence our margins in these business segments. As a substantial volume of our products may be purchased by a select number of customers, our operational results may also be dependant upon their success in the marketplace. We react to such developments by constantly widening our customer base, which has proven to be a successful strategy leading to new customer wins.

A substantial business-related risk in the semiconductor industry is that of delay, small yields, or substantial yield fluctuations in connection with the ramp-up of new technologies. We attempt to mitigate this risk by continuously improving project management and closely monitoring business processes.

In order to address the risks relating to the quality of our products we have established continuous quality improvement initiatives, such as Zero Defects and Six Sigma, within the product development, manufacturing and logistic processes. Our quality management system (which includes the deliveries of our suppliers) has been certified on a worldwide basis according to ISO 9001/TS 16949 for a number of years.

We have procured insurance coverage 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-license agreements with other companies in order to reduce the risk of claims for patent infringement. The formation of Qimonda had no effect on intellectual property protection of Infineon. Infineon strives to transfer this protection to Qimonda, in order to be prepared should the company reduce its ownership interest in Qimonda below the majority level.

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 world 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 US-dollars, not in Euros. Exchange rate fluctuations may have substantial effects on our sales, our costs and our overall results of operations.

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 actual orders received or made and all other planned revenues and expenses.

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.

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 financed 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 to create joint production facilities.

Legal Risks

Just like many companies within the semiconductor industry, Infineon has 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.

Reorganization

The reorganization of our memory products segment and the carve-out followed by the initial public offering of Qimonda, as well as any other reorganizations could have an adverse effect on our operations and not fulfill our expectations.

We intend to continuously examine and evaluate the financial and business developments, and to consider further steps of reorganization, if deemed necessary.

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 in 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, and manages the logistical processes at the group level. Infineon Technologies AG has its own production facilities in Munich, Regensburg and Warstein. Since Infineon Technologies AG enters into most transactions with derivative financial instruments on behalf of the Infineon group, the same terms and conditions are valid for derivative financial instruments as well as covered risks for Infineon Technologies AG as for the Infineon Group.

The risks and opportunities as well as the future developments of Infineon Technologies AG are to a large extent the same as the risks and opportunities and future developments of the Infineon group, as further described in the Risk Report and Outlook sections.

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

STATEMENTS OF OPERATIONS ¹ (CONDENSED) € IN MILLION			
For the years ended September 30	2004	2005	2006
Net sales	8,852	9,038	7,914
Cost of goods sold	(7,325)	(8,045)	(7,228)
Gross profit	1,527	993	686
Operating expenses	(1,533)	(1,483)	(1,289)
Equity in losses/earnings of associated companies, net	105	76	149
Other operating expense/income, net	31	79	(107)
Income (loss) before tax	130	(335)	(561)
Income tax	–	(2)	4
Net (loss) income	130	(337)	(557)
Accumulated loss brought forward	(1,339)	(1,209)	(1,546)
Accumulated loss at end of year	(1,209)	(1,546)	(2,103)

¹ Prepared in accordance with German GAAP (HGB).

Infineon Technologies AG's net sales and cost of sales decreased primarily as a result of the carve-out of the memory products business into Qimonda AG. In the 2006 financial year, the net loss resulted primarily from a decrease in gross margin caused by strong pricing pressure, and from a one-time increase of €154

million in pension liabilities. The one-time adjustment to pension liabilities was the result of the adoption of the projected unit credit method pursuant to Statement of Financial Accounting Standards No. 87 for Infineon Technologies AG in the 2006 financial year. In addition, the financial results were negatively impacted in the 2006 financial year by charges resulting from the insolvency of BenQ's German subsidiary, the carve-out of the memory products business into Qimonda AG, and the relocation of employees to Campeon, as well as by stock based compensation expenses. On the other hand, the financial results of Infineon Technologies AG were positively impacted by improved equity in earnings of associated companies, which were positively impacted by lower impairments of investments, as well as increased results from profit-transfer agreements.

BALANCE SHEETS¹ (CONDENSED) € IN MILLION

For the years ended September 30	2005	2006
Fixed and intangible assets	718	779
Investments	6.182	7.339
Non-current assets	6.900	8.118
Inventories	463	314
Receivables and other assets	1.908	1.197
Cash and marketable securities	1.886	1.057
Current assets	4.257	2.568
Total assets	11.157	10.686
Total assets	6.845	6.315
Accrued liabilities	846	750
Payables and other liabilities	3.466	3.621
Total liabilities	11.157	10.686

¹ Prepared in accordance with 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 the carve-out of the memory products business into Qimonda AG, a capital increase at Infineon Technologies Holding B.V., Rotterdam, Netherlands in the amount of €1.1 billion, as well as the merger of Eupec Europäische Gesellschaft für Leistungshalbleiter mbH, Warstein-Belecke, with Infineon Technologies AG. The reduction in shareholders' equity resulted from the net loss incurred in the 2006 financial year. Infineon Technologies AG's shareholders' equity ratio was 59% (2005: 61%).

Dividends

Since the stand-alone financial statements of Infineon Technologies AG for the 2005 financial year reported a net loss, no dividend was distributed. A net loss was also incurred in the 2006 financial year and therefore a dividend cannot be distributed.

Merger/Carve-out

Effective October 1, 2005, EUPEC Europäische Gesellschaft für Leistungshalbleiter mbH, Warstein-Belecke has been merged with Infineon Technologies AG, Munich.

Effective May 1, 2006, Infineon Technologies AG carved out its memory products business into Qimonda AG. As a result, prior period results are not entirely comparable to current period results.

Subsequent Events

During October 2006, following the insolvency of one of our largest mobile phone customers, BenQ Mobile GmbH & Co OHG, Infineon announced restructuring plans to downsize its workforce. As part of the restructuring, it is expected that a total of approximately 400 employees will be terminated worldwide, thereof almost 200 employees in the German locations of Munich, Salzgitter and Nuremberg. We anticipate that the planned restructuring will result in charges of approximately €30 million during the first quarter of the 2007 financial year, although the exact amount of the restructuring charges can not be estimated at this time due to the early stage of the negotiations with works councils.

In connection with the formation of Qimonda, Infineon and Qimonda entered into a trust agreement under which Infineon holds shares in Inotera in trust for Qimonda until the shares can legally be transferred. This trust agreement provides for Infineon to transfer the shares to Qimonda as and when Infineon receives an exemption from the statutory lock-up. On October 14, 2006, exemption from the lock-up was received from the Taiwanese Stock Exchange. Accordingly, we are in the process of finalizing the administrative steps necessary to complete the transfer of the Inotera shares to Qimonda.

On October 11, 2006, the plaintiffs filed a second amended complaint in the U.S. securities class action litigation in the Northern District of California. Our company's claim against one D&O insurance carrier was dismissed on November 13, 2006. We intend to file an appeal against this decision.

On October 23, 2006, the action filed on July 13, 2006 by the New York state attorney general in the U.S. District Court for the Southern District of New York case was made part of the multi district litigation proceeding pending in the Northern District of California.

The settlement agreement with counsel to a class of direct purchasers of DRAM in the United States was approved by the U.S. District Court for the Northern District of California in the hearing held on November 1, 2006.

In November 2006, Qimonda sold its investment in Ramtron through a private placement. As a result of the sale, Qimonda expects to record a gain of €3 during the three months ending December 31, 2006.

Outlook

World Economy

Economists generally expect a slight slowdown in economic growth in 2007 compared with 2006. The International Monetary Fund forecasts in its current world economy outlook report gross domestic product growth of 3.5% in 2007, compared with 3.8% in 2006. For 2008, economists anticipate a slight improvement in world economic growth. The slight weakening in the coming year is expected to be cyclical, as the interest rate increases of the last several quarters had a slowdown effect, and primarily reflects activity in developed economies. The high-growth economies – in particular China – are expected to continue to experience dynamic growth in 2007. The aggregate risk potential has not been reduced but rather increased; the list of risks include oil and natural gas shortages, inflation fears, and a cooling-off in the property market, particularly in the U.S. Nevertheless, there are currently no signs of a global recession. In fact, solid world-wide economic growth is expected next year and in the year thereafter.

Semiconductor Industry

The market development in 2007 and 2008 will not only be strongly dependent on the overall economic situation, but will also be impacted by the degree of market saturation in certain industry segments as a result of the extraordinarily strong growth rates experienced in previous years. Most experts expect moderate growth acceleration in 2007. In 2008, further acceleration of market growth is expected. WSTS forecasts market growth of 9% for 2007 (2006: 8%) followed by market growth of 12% in 2008 (WSTS forecast, October 2006). In the automotive electronics business, the increase in comfort and safety applications, as well as to a smaller extent infotainment applications, are expected to be among the growth drivers during the next two years. Within the wireless communication business, market growth is expected to be driven by mobile telephones despite predictions of a slowdown in unit sales growth. A positive contribution to market growth is also expected from the wireline communication business driven by broadband services that need high data rates (IPTV, video on demand). Likewise, above average growth is expected in the industrial business. The data processing technology business should also benefit from the strong demand for portable PCs in the coming two years. In the consumer electronics business, growth is expected to significantly decelerate from the high growth rates experienced in previous years, but will continue to contribute to overall growth.

Significant Planning Assumptions

In order to estimate our expected earnings development we have made certain important planning assumptions. In particular, we have assumed a U.S. dollar to euro exchange rate of 1.30 in our business without Qimonda. Furthermore, our projections exclude the effect of any non-ordinary gains or losses that may be incurred, since the amount of such non-ordinary gains or losses cannot be reliably estimated. Non-ordinary gains and losses in the 2007 financial year may arise, for example, from potential sales of Qimonda shares, as well as gains or losses resulting from general restructuring measures. Specifically, we have already defined a cost reduction program following the insolvency of one of our largest mobile phones customers, BenQ Mobile GmbH & Co OHG, which is expected to result in restructuring costs of approximately €30 million to be recognized in the Corporate & Eliminations segment in the first quarter of the 2007 financial year. We cannot give any assurance that additional restructuring costs will not be incurred. Finally, it should be noted that subsequent to the initial public offering of our majority-owned subsidiary Qimonda we are no longer in a position to make forecasts for this subsidiary. Such forecasts are now prepared by Qimonda, and are separately presented in this report. We believe that the individual analysis of our memory business is also meaningful with respect to the price development of our shares. We believe that subsequent to Qimonda's initial public offering, Infineon's market capitalization reflects the sum of the market capitalization of our subsidiary Qimonda plus the value of our remaining business activities. We believe that will continue to be the case for at least as long as we maintain a significant equity interest in Qimonda.

Net Sales of Infineon Excluding Qimonda

Based on our current plans, we expect net sales for Infineon excluding Qimonda, consisting of the Automotive, Industrial & Multimarket, Communication Solutions, Other Operating Segments and the Corporate and Eliminations segments, to remain unchanged or slightly increase compared with the 2006 financial year. This takes into account the negative effect on net sales resulting from the insolvency of our main customer in the area of processors for mobile telephones, which is expected to be reflected in the first quarter of the 2007 financial year. Therefore, we expect a sales decline in our Communication Solutions segment compared with the 2006 financial year. The Automotive, Industrial & Multimarket segment should positively contribute to net sales growth, driven primarily by sales of power semiconductors.

Beyond the current financial year we anticipate increasing sales volumes in a positive industry environment. Our fabrication plant for power semiconductors in Kulim, Malaysia, will make a positive contribution through further production ramp-up and generation of sales within the Automotive, Industrial & Multimarket segment during the full financial year. The expected ramp-ups at new customers in the wireless division of the Communication Solutions segment in the 2007 financial year may also positively contribute to sales growth in the subsequent year.

EBIT of Infineon Excluding Qimonda

We expect EBIT before non-ordinary gains and losses for Infineon excluding Qimonda to improve in the current financial year compared with the 2006 financial year.

In the Automotive, Industrial & Multimarket segment we expect EBIT results to remain unchanged or slightly improve in the 2007 financial year compared with the 2006 financial year. The unusually strong demand experienced in the first half of the 2006 financial year will probably not repeat itself in the current financial year. In the current financial year, the Automotive, Industrial & Multimarket's EBIT results will continue to be negatively impacted by costs in the mid double-digit million range incurred in connection with the ramp-up of production at our production facility in Kulim, Malaysia, as well charges related to the ramp-down of our production facility in Munich, Germany. Furthermore, following the separation of Qimonda into a standalone legal entity, the Automotive, Industrial & Multimarket segment is expected to bear additional costs allocated from central activities during the first half of the financial year. This effect should be compensated in the second half of the financial year by cost cutting measures introduced by the Infineon Complexity Reduction program ("ICoRe"), as further described below. The anticipated savings resulting from the ICoRe program have not been considered in the outlook of the Automotive, Industrial & Multimarket segment described above. Production ramp-ups at new customers in the Communication Solutions segment will have a positive effect on EBIT before non-ordinary gains and losses. In addition, we anticipate a positive effect in the current financial year from the implementation of cost reduction measures which are expected to have a €40 million annual cost-saving impact. We expect EBIT before non-ordinary gains and losses in the wireless communication business to break-even by the end of the 2007 calendar year. On the other hand, we expect a negative impact from the insolvency of our main customer for baseband processors. In addition, EBIT results of the Communication Solutions segment include expenditures in connection with the fabrication facilities referred to above. On a net basis, EBIT before non-ordinary gains and losses is expected to remain negative for the 2007 financial year. The execution of all customer projects within the wireless communication business as

currently planned and the timing of completion of ongoing cost reduction programs will determine whether the segment's EBIT remains at approximately prior year levels or improves. As with the Automotive, Industrial & Multimarket segment, cost cutting measures introduced by the ICoRe program, as further described below, are expected to contribute to the improvement of EBIT before non-ordinary gains and losses in the current financial year compared with the 2006 financial year. The anticipated savings resulting from the ICoRe program have not been considered in the outlook of the Communication Solutions segment described above. In the 2007 financial year, the non-recurrence of expenditures incurred during the 2006 financial year in connection with the separation of the memory products segment into a standalone legal entity and costs related to the move to our new corporate headquarters, Campeon, are expected to positively impact EBIT results prior to inclusion of potential restructuring charges in the Corporate and Eliminations segment.

The implementation of the ICoRe program, which is currently in its planning phase, is expected to positively impact EBIT results in all segments. We expect to finalize the planning phase of the program in the 2006 calendar year and to implement it in the 2007 financial year. As a result of the ICoRe program, annual savings of at least €50 million are anticipated, which will impact results partially in the current financial year and fully in the next financial year.

Beyond the 2007 financial year, we expect EBIT before non-ordinary gains and losses to improve as a result of a positive industry environment and further sales growth in the logic business. In the Automotive, Industrial & Multimarket and Communication Solutions segments, the non-recurrence of expenditures incurred in connection with the ramp-down of the production facility in Munich/Perlach and the ramp-up of the production facility in Kulim, Malaysia will be a driver of the improvement. In addition, both segments will fully benefit from the cost-saving measures of the ICoRe program. Furthermore, the cost reduction measures to be implemented in the 2007 financial year in the Communication Solutions segment should positively impact results.

Fixed Assets Investment and Depreciation for Infineon Excluding Qimonda

We are pursuing a differentiated manufacturing strategy for our Automotive, Industrial & Multimarket and Communication Solutions segments. In the context of this strategy, we will continue to invest in manufacturing capacities for special processes, in particular in the power semiconductor arena. In contrast, we do not plan to invest in our own manufacturing capacities for the standard semiconductor manufacturing process, so called CMOS technology, for structure sizes below 65-nanometers, but will

outsource this capacity to foundry partners. In the context of this manufacturing strategy we anticipate that our annual fixed assets capital investment will be approximately €500 million. Compared with the 2006 financial year, depreciation expense is expected to be reduced to approximately €600 million in the 2007 financial year and to continue to decrease in line with capital investment in the years thereafter. In the subsequent financial years we expect annual depreciation expense to be approximately €500 million.

Expenditures for Research and Development for Infineon Excluding Qimonda

We expect expenditures for research and development for Infineon excluding Qimonda to slightly decrease in the current financial year compared with the 2006 financial year. This is primarily due to the cost reduction measures already initiated within the Communication Solutions segment. By streamlining internal organization structures and reducing fixed costs, we believe that we will be able to reduce development expenditures while retaining our sales potential. In Automotive, Industrial & Multimarket, the introduction of new products and the broadening of the existing product portfolio in automotive power, microcontrollers and power management are examples of areas of emphasis in research and development. In Communication Solutions, we are working, for example, on new system-on-a-chip products for wireless and wireline communication. Beyond the 2007 financial year, a slight increase in expenditures for research and development is possible.

Qimonda Segment

Qimonda's revenues are a function of the bit volume it ships and the selling price it achieves for its products. While Qimonda has an influence over its production growth, through capacity additions and productivity improvements, its sales volume depends on the extent to which its product offerings match market demand. Qimonda's selling prices are a function of the supply and demand relationship in the DRAM market. These market forces are beyond Qimonda's control and, accordingly, it cannot reliably estimate what these future sales prices, and the resulting revenues and the contribution to its earnings, will be.

For the 2007 financial year, Qimonda expects bit demand to be driven in part by the introduction of the Windows Vista operating system and the continued strong growth for DRAM in consumer and communication applications. More specifically, Qimonda expects the overall DRAM market, measured in bits, to grow between 55 % and 65 %. Qimonda intends to increase its bit production in line with overall market growth based on its investment in additional capacities in the Richmond 300-millimeter manufacturing facility and the ramp-up of the second 300-millimeter module at the Inotera joint venture. In addition, during the 2007 financial year, Qimonda aims to realize productivity improvements in manufacturing as it converts further production to

90-nanometer technology and begins the transition to next generation 80-nanometer and 75-nanometer technologies. Qimonda is continuously taking steps to reduce its cost-per-bit in manufacturing, such as the introduction of advanced process technologies featuring smaller die-sizes, the ramp-up of more productive 300-millimeter capacities and other cost savings and productivity improvement measures.

Qimonda expects to make capital expenditures in the 2007 financial year ranging between €750 million and €850 million. In the years thereafter, its aim is to have capital expenditures of approximately 15 % to 25 % of revenues on average over the DRAM cycle.

Depreciation and amortization during the 2007 financial year is estimated to range between €650 million and €750 million, and for the years thereafter to be in line with capital expenditures.

Research and development expenses are anticipated to be between €430 million and €460 million for the 2007 financial year, and approximate 10 % of sales on average for the years thereafter.

Historically, Qimonda has received financing from us. Depending on market conditions and Qimonda's financial performance in the coming year, it may redeem a portion or all of this debt through repayment and/or external refinancing.

Opportunities

The Automotive, Industrial & Multimarket as well as the Communication Solutions segments provide particularly volume opportunities in connection with a better than expected development in demand in our target markets. In the Communication Solutions segment, we focus particularly on the continuous broadening of our customer base, especially in the area of mobile phone platforms. The primary risk being that certain customer projects do not lead to orders, or that customer projects do not match our planned time table or anticipated order volume.

For Qimonda's memory products business, we see the greatest opportunities within a positive development of DRAM prices, particularly due to higher than expected demand in connection with temporary shortages caused by delivery bottlenecks in the market. In manufacturing, efficiencies could be further increased and our cost position improved. In addition, we consider the continuing optimization of our product portfolio to be a significant opportunity for the sustainable improvement of our operating results. The primary risk lies on a significant weakening of the average selling prices of memory chips.