

Infinion Technologies Condensed Report 2005

# Gaining momentum



Never stop thinking

**Infineon key data as of and for the financial year, ended September 30<sup>1</sup>**

	2004		2005		2005 - 2004
	€ millions	as % of net sales	€ millions	as % of net sales	change in %
<b>Net sales</b>	7,195		6,759		(6)
<b>By region</b>					
Germany	1,675	23	1,354	20	(19)
Other Europe	1,263	18	1,210	18	(4)
North America	1,524	21	1,504	22	(1)
Asia-Pacific	2,263	32	2,223	33	(2)
Japan	364	5	332	5	(9)
Others	106	1	136	2	28
<b>By segment</b>					
Automotive, Industrial and Multimarket	2,540	35	2,516	37	(1)
Communication	1,689	24	1,391	21	(18)
Memory Products	2,926	41	2,826	42	(3)
Other Operating Segments	11	-	12	-	9
Corporate and Reconciliation	29	-	14	-	(52)
<b>Gross margin</b>	2,525	35	1,850	27	(27)
Research and development expenses	1,219	17	1,293	19	6
Operating income (loss)	314		(268)		-
Net income (loss)	61		(312)		-
EBIT EBIT margin	256	4	(183)	(3)	-
Earnings (loss) per share – basic and diluted in €	0.08		(0.42)		-
Dividend per share in €	-		-		-
Net cash provided by operating activities	1,857		1,039		(44)
Net cash used in investing activities	(1,809)		(238)		87
Net cash used in financing activities	(402)		(266)		34
Free cash flow <sup>2</sup>	206		(281)		-
Depreciation and amortization	1,320		1,316		-
Impairment charges	136		134		(1)
Purchases of property, plant and equipment	1,163		1,368		18
Gross cash position <sup>3</sup>	2,546		2,006		(21)
Net cash position <sup>4</sup>	548		341		(38)
Property, plant and equipment, net	3,587		3,751		5
Total assets	10,864		10,284		(5)
Total shareholders' equity	5,978		5,629		(6)
Equity-assets ratio	55 %		55 %		-
Return on equity <sup>5</sup>	1 %		(5 %)		-
Return on total assets <sup>6</sup>	1 %		(3 %)		-
Equity-to-fixed-asset ratio <sup>7</sup>	167 %		150 %		(10)
Debt-to-equity ratio <sup>8</sup>	33 %		30 %		(9)
Debt-to-total-capital ratio	18 %		16 %		(11)
Employees	35,570		36,440		2

1 Columns may not add due to rounding.

2 Free cash flow = Net cash provided by operating activities minus net cash used in investing activities adjusted by purchases (proceeds from sales) of marketable securities available for sale.

3 Gross cash position = Cash and cash equivalents plus marketable securities.

4 Net cash position = Gross cash position minus short and long-term debt.

5 Return on equity = Net income (loss) divided by average shareholders' equity employed.

6 Return on total assets = Net income (loss) divided by average total assets.

7 Equity-to-fixed-asset ratio = Total shareholders' equity divided by fixed assets.

8 Debt-to-equity ratio = Long-term and short-term debt divided by average shareholders' equity.



Title

In future, not only voice and data but also entire films and sports events will be transmitted at the same time through telephone lines. VDSL2, the latest broadband technology, makes this possible. We are a market leader in this field with our VINAX chip.

## Setting the pace.

In 2005, we moved Infineon decisively forward – by optimizing our structures, enhancing personal responsibility, strengthening customer focus, and increasing efficiency.

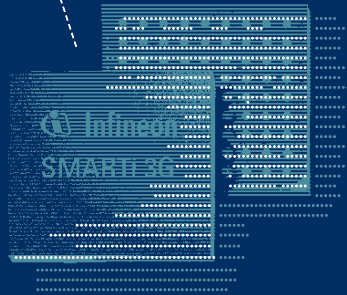
## Gaining momentum.

In 2006, we will give Infineon a new strategic direction to make the most of our opportunities for growth. Working as two independent companies will give us a competitive advantage, allowing us to realize new potential and to pursue consistently profitable growth.

2	Shareholder information	16	Communication
4	Letter to the shareholders	18	Memory Products
9	The Management Board of Infineon Technologies AG	20	Condensed financial review
10	The Infineon share	22	Condensed operating and financial review
12	Our Company	38	Consolidated financial data
14	Automotive, Industrial and Multimarket	44	Further information

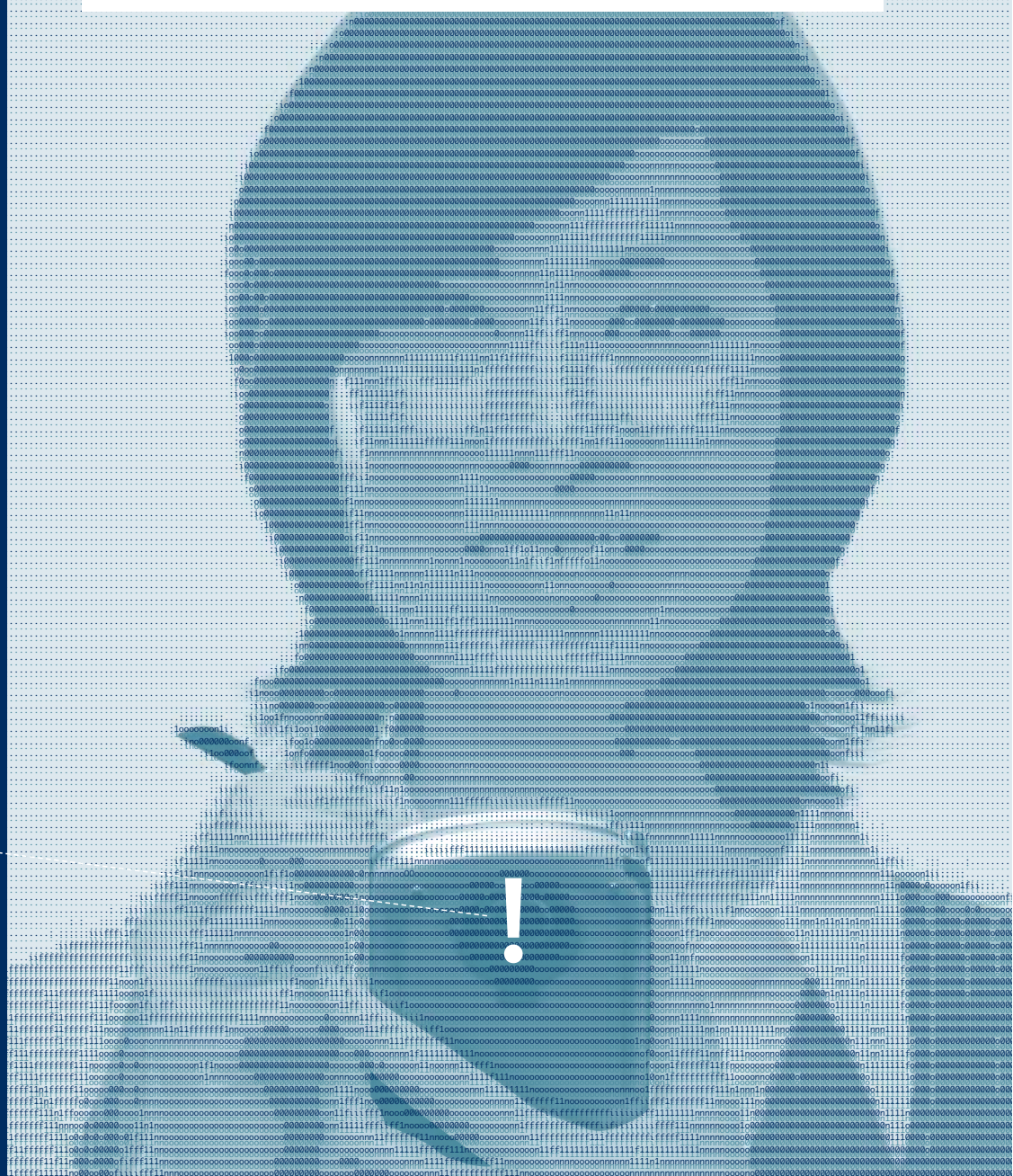
# SMARTi 3G

Nearly every major mobile phone manufacturer uses our radio frequency (RF) transceivers. Our latest product for 3G mobile phones, the SMARTi 3G, should ensure this continues. It is particularly versatile: the only RF transceiver so far that can be used on all of the world's UMTS networks, enabling you to use your phone everywhere. Whether at home, on the shore of Huanpu or at the foot of Popocatepetl.



Infinion Technologies Condensed Report 2005

# Shareholder information



## Letter to the shareholders

Dr. Wolfgang Ziebart  
President and CEO of Infineon Technologies AG



Ladies and Gentlemen,

The 2005 financial year was an eventful one for Infineon, a year in which we tackled and successfully achieved many things. We have made great progress. Through extensive restructuring measures, significant cost cutting and corporate reorganization, we have succeeded in aligning Infineon closer with the market. Yet we have also been confronted with challenges: a severe drop in the price of memory and chip-card products as well as a massive decline in sales at one of our key customers in the mobile phone sector. Due to these negative effects, our results do not reflect the progress we have made. Our sales fell year on year by 6 percent to €6.76 billion, resulting in a loss before tax and interest of €183 million, compared to a profit of €256 million in the previous financial year. However, this year's figure includes an exceptional pre-tax charge of €104 million.

Even though the past year's results may somewhat impede one's view, I would like to draw your attention to the continual progress that we on the Management Board are pursuing. In the past financial year, we undertook a clear change in direction. In the past, Infineon had pursued a strategy focused primarily on growth and had accordingly won considerable market share. By this means we achieved critical mass and gained a strong market position, building the basis for the future. Yet changes in all sectors of the semiconductor industry now require that we concentrate on profitable growth. I would like to explain to you the steps already taken in this direction over the past year, and then indicate the measures that we will be implementing in the future.

In the last financial year we undertook several fundamental organizational changes. The most significant was the corporate reorganization accomplished at the start of

2005. In creating businesses with significantly greater autonomy and more room to manoeuvre, we have today moved business decision-making deeper inside the company than before. We are thus not only acting more flexibly, but also shortening our decision-making processes considerably and raising our efficiency. Each operating segment today is the responsibility of one member of the Management Board. In addition, we have integrated our central research department in the individual segments in order to turn research-driven innovation more rapidly into new products.

In the past financial year we also immediately addressed those issues where, in our opinion, there was an obvious need for action. The new, more strongly divisional structure made this much easier. We launched a program which resulted in cost levels that were €320 million lower than originally planned. We terminated or sold operations which do not form part of our core business. These included, for example, the sale of Infineon Ventures and the streamlining of the Emerging Business Portfolio which comprised, among other activities, Wearable Electronics and Biochip. Within our core business we identified those businesses where the probability of returning to profit was small. Despite their outstanding technology, we either sold or terminated these activities. For example, we discontinued our controller activities in the mobile phone infrastructure business, parts of our fiber optics business were sold to Finisar, and we sold the majority of our optical network business activities to Exar. In addition, we integrated strategically important parts of the fiber optics business into the Automotive, Industrial and Multimarket segment. Today, we can already see that these decisions were correct. These measures in the field of wireline communications served to focus the business while broadband-access products are already showing truly excellent progress with significant gains in market share. The wireline business is today more successful than for a long time.

In two significant businesses we identified the potential for profitable future development. Both these businesses, namely, base-band processors for mobile phones and security and chip card ICs, are currently implementing a clearly defined restructuring plan. In the case of base-band processors, we have developed an aggressive and systematic plan designed to help us gain new customers. It is based on the further development of our world-leading radio frequency technology as well as on new processors for mobile phones. These technologies will be complemented by UMTS/EDGE/GSM-protocol software. We are thus in a position to offer the market an outstanding, highly competitive range of mobile phone platforms scaleable from the low-tech entry segment to the high-end. By these means, we should achieve significantly improved results by the end of the 2006 financial year. Following enormous

efforts in cost saving and product development, one can foresee that the position in security and chip card ICs will also have improved significantly by the end of the 2006 calendar year. We will be focusing more strongly on products with higher added-value such as access technologies, payment and identification systems. Improving our profitability here has clear priority over maintaining our share of the world market, which is currently around 40 percent. We are confident that we will be successful in achieving our objective of profitable growth.

Through the measures described, we have restructured over the past year those areas of the company which were in most urgent need of reform. Now I would like to address the steps we are going to take in the forthcoming financial year. For some considerable time there have been signs of fundamental change in the semiconductor industry. Above all, we observe that the growth of the whole semiconductor sector is slowing. In future there will also be significant differences in the rates of growth of individual segments. What is more, we are experiencing the increasing specialization of companies in terms of development and production. Current production models will not survive unchanged because of market shifts and specialization. Moreover, in certain segments, system solutions are gaining increasing prominence over individual products.

These changes require a greater degree of differentiation in the corporate structure, going beyond the divisional organization of the company that has already been implemented. In the past, we were always able to recognize and make use of synergies in the production of memory and logic products within the same company. However, in view of their different technological development, such synergies will become rare in the future. Markets and the customers as well as product and process development are diverging increasingly, both for memory and logic products. High volume production of memory products will remain highly capital-intensive and process-driven owing to the complex technology involved. By contrast, we believe logic products will have highly differentiated markets with low-volume production of individual products and with growing demands on system solutions. The close involvement of customers in product development is a key success factor here. Our portfolio of technologies and production processes thus has to be led by customer demand; the centrally managed provision of the latest production processes and capacities is too cost-intensive. Moreover, the speed at which innovation takes place in the memory and logic businesses is increasingly different. While some logic products have life cycles ranging from a few years up to a decade, memory products are rebuilt annually. This calls for the fastest possible introduction of the latest and



most economic production technologies, making for a highly capital-intensive business.

Compared to previous years, we see today and in the future a decidedly different development in respect of memory and logic products. This leads to different requirements in structures and business models as well as in management and strategy.

For this reason, we have decided to make the memory business an independent legal entity. An IPO at a later date is our preferred option. We are convinced that such a separation offers a variety of new opportunities to both the Memory Products and the Logic segments. The carve-out will give the Memory Products segment the opportunity to access capital markets independently. In a capital-intensive industry, this is a crucial competitive factor. Legal independence will also make it easier for the Memory Products segment to consider opportunities for cooperation. The company's Logic segments could use funds from a memory IPO to strengthen their core business by selective acquisitions. Finally, once the Memory Products segment has gone public, investors will have the opportunity to pursue a more differentiated investment strategy.

We will not only transform the Memory Products segment into an independently operating company, but we will also make a number of changes to Infineon's Logic segments. In the future, we will pursue a differentiated product strategy for our logic products. For modules which are mainly produced using the standard process of semiconductor manufacturing, the so-called CMOS technology, we will not invest in our own manufacturing capacity for 65-nanometer technologies. However, in the field of power and radio-frequency semiconductors we will continue to undertake internally the requisite special manufacturing process since these specialized manufacturing abilities still represent an essential competitive factor. In this context, I would like to mention our new production site in Kulim, Malaysia, which we are building specifically for the manufacture of power semiconductors for the automotive and industrial sectors. The markets for these products are constantly growing and in many segments Infineon is market leader. This new production site will commence production in the fall of 2006.

I hope that I could convey to you through this brief exposition how we have been addressing with truly significant issues for our company over the past months. Having strategically assessed our position thoroughly, we have decided to implement

systematically the measures we identified. The future development of our company lies in our own hands. We must do everything we can to make 2006 a better year for us all, even if experts' forecasts for the semiconductor market once again presuppose single-digit growth.

Despite the restructuring activities and the changes to their day-to-day work, our employees continue to display excellent performance and dedication to the company's future. Personally, and on behalf of the entire Management Board, I would like to express my thanks to them. Together, over the last year, we have already achieved a great deal: a successful and forward-looking reorganization of the company, as well as the repositioning and restructuring of many businesses. I am convinced that together we will successfully master the challenges that still lie ahead.

Munich, November 2005

Yours sincerely

A handwritten signature in blue ink, appearing to read 'W. Ziebart', written in a cursive style.

Dr. Wolfgang Ziebart  
President and CEO

## The Management Board of Infineon Technologies AG



From left:

.....  
**Prof. Dr. Hermann Eul**  
 Head of Communication segment  
 Doctorate in electrical engineering (Dr.-Ing.); member of the Management Board since July 2005

.....  
**Peter J. Fischl**  
 Chief Financial Officer (CFO) and Labor Director  
 BA equivalent degree in business and finance; member of the Management Board since April 1999

.....  
**Dr. Wolfgang Ziebart**  
 President and Chief Executive Officer (CEO)  
 Doctorate in mechanical engineering (Dr.-Ing.); member of the Management Board since September 2004

.....  
**Peter Bauer**  
 Head of Automotive, Industrial and Multimarket segment  
 Electrical engineer (Dipl.-Ing.); member of the Management Board since April 1999

.....  
**Kin Wah Loh**  
 Head of Memory Products segment  
 Chemical engineer (BSc); member of the Management Board since December 2004

## The Infineon share

### Infineon shares did not benefit from positive stock market trends

Infineon share price virtually unchanged over reporting year.  
DJ Stoxx Semiconductor index up 13 percent in the 2005 financial year.  
On average, 9.7 million Infineon shares traded daily in the past financial year.

Last year, chip stocks were not able to benefit fully from the positive mood on the stock market. While the DJ Stoxx semiconductor index gained only 13 percent, the DJ Stoxx 50 and Dax indices rose 22 and 30 percent respectively. This discrepancy was due in part to reductions in earnings estimates for many semiconductor companies facing underutilized capacity as overstocked inventories were run down at their customers.

Infineon was affected by this trend, but also faced considerable price pressure in the DRAM and chip card business, as well as a significant loss of market share by one of its most important customers in the mobile phone market. These factors contributed to make Infineon shares lag the semiconductor sector over the year. Infineon shares began the financial year in line with the market, reaching an annual high of €9.00 on November 18, 2004; then the share price began to decline, hitting a year low of €6.43 on April 29, 2005. In

this period in particular, Infineon lost ground in comparison with other semiconductor shares. Thereafter, Infineon shares recovered along with the market and ended the reporting year at €8.18, compared with €8.22 a year before. The virtually unchanged share price did not improve the disappointing long-term trend; Infineon stock remained 77 percent lower than its IPO price on March 13, 2000. Relative to the DJ Stoxx Semiconductor index, however, Infineon stock declined by somewhat less over the period.

Last financial year, Infineon stock trading volumes fell for the first time, after rising continually since the IPO. Over the period, an average of 9.7 million Infineon shares were traded on Xetra, in Frankfurt and on regional stock markets, representing a decline of 18 percent from the previous year. This, however, constituted 9.5 percent of total Dax 30 trading, with only one Dax 30 company achieving higher trading volumes.

**Relative performance of Infineon shares as compared to the Dax and DJ Stoxx Semiconductor indices since the beginning of the 2003 financial year (closing prices)**



## Infineon share statistics

Financial year (to September 30)	2004	2005
<b>Europe</b> Xetra close in €		
Year high	13.65	9.00
Year low	7.80	6.43
Financial year close	8.22	8.18
Average daily trading volume individual shares	11,743,938	9,666,303
of which Xetra trading in %	96	97
<b>USA</b> NYSE close in U.S. \$		
Year high	15.87	11.47
Year low	9.39	8.40
Financial year close	10.22	9.92
Average daily trading volume	896,317	583,101

## Long-term performance of Infineon shares with indices in %

Period to September 30, 2005	Since IPO on March 13, 2000	Since October 2003	Since October 2004
<b>Europe</b>			
Infineon (Xetra)	(77) <sup>1</sup>	(27)	0
DJ Stoxx Semiconductor	(84)	(13)	13
DJ Stoxx Technology	(75)	29	21
DJ Stoxx 50	(35)	37	22
Dax	(34)	55	30
<b>USA</b>			
Infineon (NYSE)	(71) <sup>1</sup>	(23)	(3)
Philadelphia Semiconductor Index (SOX)	(64)	13	24

1 Based on issue price of €35/\$33.92.

## Share capital, shares outstanding, and market capitalization of Infineon Technologies AG

As of September 30	2004	2005	Change
Share capital € in millions	1,495	1,495	0%
Shares outstanding € in millions <sup>1</sup>	748	748	0%
yearly average in millions <sup>1</sup>	735	748	+2%
Market capitalization € in millions	6,149	6,119	0%
Market capitalization U.S. \$ in millions	7,645	7,420	(3%)

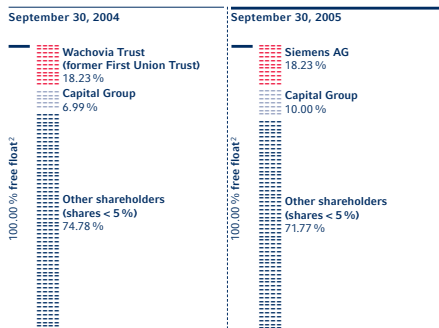
1 Undiluted.

## Infineon pays no dividend

The Infineon Management Board and Supervisory Board will not be able to propose a dividend at the Shareholders' General Meeting, since Infineon Technologies AG, the parent company of the Group, did not achieve an accumulated profit for the year. The accumulated loss for the 2005 financial year came to €1,546 million compared to an accumulated loss of €1,209 million in the previous year.

## Shareholder structure

Infineon is aware of two changes in its shareholder structure that were subject to disclosure requirements over the past year. As of May 12, 2005, Capital Group increased its share in the Company to 10.00 percent, while the shares held by the Wachovia Trust Company National Association were transferred back to Siemens on November 28, 2004. Siemens has thereby regained the voting rights connected to the shares in question.

Shareholder structure<sup>1</sup>

1 In accordance with companies' mandatory reporting, as known to Infineon.

2 Free float according to FTSE definition. Deutsche Börse and Stoxx do not include Siemens AG or Wachovia Trust shares in Infineon free float.

Please feel free to direct your questions to Infineon Investor Relations in Munich, Germany, and San Jose, California.

## Munich office

Tel. +49-89-234-26655

Fax +49-89-234-26155

## San Jose office

Tel. +1-408-501-6800

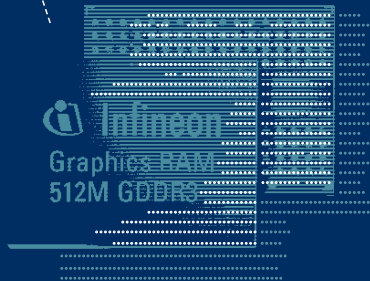
Fax +1-408-392-8023

## E-mail

investor.relations@infineon.com

# 512M GDDR3

Graphics users are amongst the most demanding of computer customers. They need ultra-fast graphics memory to build into game consoles and graphics cards. Gamers are only happy when images from complicated graphics, scenes, and animations flow smoothly. Only a handful of manufacturers offer the requisite components. In our case, this is the 512M GDDR3.



Infinion Technologies Condensed Report 2005

# Our Company



## Automotive, Industrial and Multimarket Electronics provide more security, efficiency, and convenience

Our semiconductors for automotive electronics meet highest quality standards in the industry. Energy consumption can be reduced through intelligent use of motors and lamps. We deliver highest security for identity cards, passports, and networks.

### Automotive electronics: driven by fuel saving and passenger safety

In the automotive industry, manufacturers and electronics suppliers depend upon strong planning and long-term customer relations because of long product life cycles. Infineon, number one in European automotive and number two worldwide, also maintains stable business relations with over 200 customers directly, and with several thousand indirectly through distribution partners. Many Infineon customers are based in Europe where most automotive innovations are still conceived.

Increased driver concern about safety and convenience has steadily raised the proportion of electronics and thus the number of semiconductors in each car. Quality is of the greatest importance for all automotive products, including the semiconductors used in vehicle applications. Infineon has therefore introduced its Automotive Excellence Program to meet these superlative standards. The program's goal is to ensure that absolutely no component defects arise. In July 2005, Continental Automotive Systems presented its "Supplier of the Year 2004" award to Infineon, the first semiconductor company to receive the honor. This clearly demonstrates the success of this program.

Technical developments that save fuel and reduce emissions are also becoming increasingly important. The 32-bit microcontrollers of our TriCore family of products, which are used for engine and transmission control, and in particular the → **TriCore TC1796**, make use of their immense computing power to achieve greater engine efficiency and to fulfill the highest requirements in efficiency, and fuel and emissions optimization.

A further automotive trend is the replacement of mechanical and hydraulic components by electrical systems. This requires high voltages to be regulated with the minimum possible heat. Infineon has developed its → **OptiMOS-T** product range specifically for automotive applications.

Demands for increased car safety and new traffic safety regulations have driven the development of pressure, rotation speed, magnetic field, shock, and roll-over sensors. This segment of automotive semiconductors further promises high growth rates.

### Industrial electronics: demand higher efficiency and smaller components

In the past financial year, Infineon has newly organized its industrial business, expanding its microcontroller range and its power product portfolio, which includes products for electric motor drive control. We place particular emphasis on the development of highly efficient power transistors, and the reduction in size of components and modules used in power supply units. Switching power supplies used in PCs, notebooks, and consumer electronics are our main focus. They can also be found in electrical drives for air conditioners, washing machines, industrial automation, trains and wind turbines.

Industrial control can be extended to energy conversion and load-control applications. A great deal of power can be saved if engines and pumps are flexibly controlled according to need, rather than with a basic on-off switch. These devices are known as variable-speed drives. Digital power management in power semiconductors is increasingly used in industrial and automotive applications.

### Chip card: the highest of security requirements

Personal identification (passports, identity cards, and health insurance cards) and forms of payment (credit and debit cards) are the primary driving forces behind security chip growth. Both contact and contactless chip cards need to meet the highest security and performance requirements.

SIM cards have also gained in importance, particularly through the immense growth of the mobile phone market in emerging countries. Low security standards



for cards in those countries have, however, led to low barriers to market entry, and thus high competitive pressure on chip manufacturers. Cards with memory configurations from 8 to 64 kilobytes have finally become a commodity business with the usual low profit margins. In order to increase the profitability of this business, we have introduced low-cost versions and expanded our contactless security applications portfolio. Over the past financial year, for instance, we have brought a new production technology to market, as well as the → **MicroSlim** memory technology, and the module-mounting technology, Flip Chip On Substrate (→ **FCOS**).

The Company's early entry into the PC and network security market with Trusted Platform Modules (TPM) has paid off. PC manufacturers will begin to install the latest version of these chips (→ **TPM 1.2**) in their products over the coming months. Infineon is the only company that supplies both chips and the associated software.

**ASIC & Design Solutions: customized chips include great system expertise**

In our ASIC & Design Solutions business, we translate our wealth of know-how, patents, and system expertise into new products that we develop in close cooperation with our customers. With this approach, we can shorten the development phase and enable our customers to introduce new products with fast time to market. The most recent example is our cooperation with Microsoft, whose Xbox 360 game console includes three of our components (→ **plug-in memory module, security chip, gamepad controller**).

**Sites expanded in Asia and Europe**

The construction of our new factory for the production of power semiconductors used in the automotive and industrial sectors in Kulim High-Tech Park, Malaysia, is proceeding according to plan. The first clean-room equipment is expected to be installed there in March 2006, with production planned to begin in the last quarter of the 2006 calendar year. With this investment, we are securing the expansion of our production capacity to support our growth, while cutting our manufacturing costs considerably, thanks to the factory's lower level of labor costs.

We have also expanded our development activities in the past financial year. We opened, for instance, a new development center in Bucharest, Romania, in April 2005, and expanded our research centers in Villach, Austria, and Padova, Italy.

**Infineon innovations**

**TriCore TC1796**

Engine control is one of the most computationally intensive and time-sensitive tasks in an automobile. We have designed the TriCore 32-bit microcontroller range for these complicated real-time calculations. The TC1796, with 40 million transistors, is, to date, the most complex of our automotive components.

**OptiMOS-T**

Direct current converters such as those found in notebooks, network servers, and even in cars, are typical of applications supported by our OptiMOS product range. We have developed our new Trench 55V technology (OptiMOS-T) specifically for automotive use.

**MicroSlim**

The memories based on the MicroSlim technology can in the future be built with only one transistor per bit cell instead of the current two. This reduces chip size and production cost.

**FCOS**

Flip Chip On Substrate (FCOS) is a new process that connects silicon dies with the golden contact surface of the chip card. The chip is secured with its surface face down (flip chip) on the substrate.

**TPM 1.2**

Delivery has begun of the second generation of TPM chips for PC and notebook manufacturers. Over time, we expect these chips also to be used for set-top boxes, game consoles, and mobile phones.

**Plug-in memory module, security chip, gamepad controller**

These ASICs are used, for example, in the basic equipment and accessories. The plug-in memory module can store scores of games. The security chip ensures accessories function properly. Furthermore, the gamepad controller works remotely thanks to our wireless chips.

## Communication

### Wireline and wireless communications converge

Our technology enables low-cost phones for emerging markets as well as high-end multimedia phones. Our VDSL2 solution sets record rates for data transmission. Infineon links wireline and wireless communication devices in the digital home.

#### Movement in communication technology

Strong demand for mobile phones in emerging markets was a positive trend in the past year. This was the main reason for the significant growth in units sold, from 520 million units in 2003 to 674 million in 2004; with the rest of the growth coming from consumers upgrading to the latest models. Prices for entry-level models continued to decline in 2005, and this trend is likely to continue in 2006. Low-cost mobile phones provide voice and text transmission functions without extra features such as games and cameras and their production costs are expected to fall below \$20 in 2006.

The mobile phone business is further characterized by the faster introduction of new product generations and the increasing integration of electronic components. Additional functions such as cameras and MP3 players are leading to increasingly complex chips. However, due to rapidly decreasing costs, we expect the global mobile phone market to be flat or even decline in terms of revenues in 2006.

In wireline communications, we view the convergence of voice, data, and TV data networks as an overriding development with a wide range of effects. Voice over Internet Protocol (VoIP) allows the transmission of spoken words as digital packets via a computer network, rather than via an analog telephone line. In new hotels, universities, or company buildings, such as our own Campeon headquarters, analog telephone lines are therefore in fact no longer installed. Moreover, telecommunications companies are expected to upgrade existing voice networks with data networks based on Internet Protocol in the future, thereby realizing significant savings.

VDSL2 is now seen as the most capable transmission standard for the distance of the "last mile" over the copper wires to the customer, following on from ISDN, ADSL, ADSL2, ADSL2+ and VDSL. With a bandwidth of up to 100 megabits per second, VDSL2 enables triple-

play, combining the transmission of several television channels in HDTV quality, voice transmission, and a high-speed Internet connection. In the home, too, we see continuous development in connecting consumer electronic devices, by wireline or by wireless. Home gateway solutions operate as integrated access points, combining voice, video, and data services, and work as routers to set up and control home networks.

#### The right product for every trend

As communication technology specialists, we support all of the world's major mobile phone standards, including GSM, GPRS, EDGE, and UMTS. Telephone manufacturers are concentrating more and more on features and functions, product variety and design, and therefore increasingly purchase complete system platforms from chip suppliers. We have accordingly moved forward in our software and system development, and are today offering platform solutions for all market segments (→ **Reference platforms ULC** and **MP-E**). For low-cost telephones, we have developed the Ultra-Low-Cost (ULC) platform with the → **E-GOLDradio** one-chip solution, which integrates baseband and high-frequency transceivers into one chip using CMOS technology.

For the mid-market segment, we have integrated the most popular multimedia applications into our baseband chips; our S-GOLD2 is a first example of this new generation. We are also developing the relevant software for these chips, such as EDGE and UMTS protocols, and have designed APOXI, a platform for application software. We also design software for smart phones that ensures the compatibility of our baseband chips with the most common application processors which are not developed by Infineon itself.

In the field of wireless communications, Infineon has played a leading role in the transition of high-frequency transceivers from BiCMOS to CMOS production technology. Infineon has introduced SMARTi SD in high pro-

duction volumes to the market, the world's first single-chip CMOS transceiver for GSM and GPRS, followed by → **SMARTi PM** for EDGE and → **SMARTi 3G** for UMTS.

As the global market and technology leader for high-frequency transceivers, we are now focusing intensively on connectivity solutions, combining a variety of radio frequency standards, including WLAN, GPS, Bluetooth, and DECT into one device, or even onto a single chip. Infineon is also a leader in the production of chips for digital television tuners, and is now playing a major role in launching digital terrestrial television DVB-T (Digital Video Broadcast-Terrestrial) (→ **DVB-T tuners**). In Korea, the first country in the world to adopt this service, mobile phones can even be used to watch television. The first phones that contain Infineon's tuners are now available there.

### At high speed along the last mile

We are enjoying success with our chips for digital voice transmission in computer networks (Voice over IP). The excellent quality of our DSL access technology products (→ **GEMINAX Pro**, → **VINAX**) secures competitive advantages in power consumption and DSL line performance. Infineon is one of the few companies serving both ends of the communications network – from the central office to the individual customer. We produce, for example, the complete xDSL access technology for applications, including broadband in the home and digital home networking. We also provide complete broadband communications solutions for customer-premises equipment. Our customers can in addition choose from a comprehensive range of conventional products for analog telephone connections, ISDN connections, and T/E carriers.

### Research and development and joint ventures

A key activity is the further development of our process technology. To secure competitive advantage at low cost, we have entered into partnerships with consortia and companies such as IBM, Chartered Semiconductor Manufacturing, and Samsung. Currently, our 130-nanometer technology is running in volume production, we are launching several products in the 90-nanometer technology, and the qualification phase has begun for the 65-nanometer technology. We have also started development of the 45-nanometer process.

## Infineon innovations

### Reference platform ULC

Telephones based on the reference platform for low-end GSM/GPRS mobile phones have less than 100 components, with the electronics required by the system needing just 9 cm<sup>2</sup>. High-end telephones, by contrast, require over 200 components and around 30 cm<sup>2</sup> of circuit board area. Using the E-GOLDradio as baseband chip, the ULC platform supports voice telephony, SMS, and a color display. In the future, this will make it possible to manufacture telephones for under \$20.

### Reference platform MP-E

Our reference platform for GSM/GPRS/EDGE multimedia mobile phones in the mid-price range is based on the S-GOLD2. MP-E supports all usual frequency ranges, a camera, polyphonic ring tones, and a color display. These platforms are sought by mobile phone manufacturers looking for complete single-provider solutions.

### E-GOLDradio

Combines a quad-band high-frequency transceiver and a baseband processor in a single chip. This makes it the world's first and most highly integrated monolithic one-chip solution for the two most important mobile phone components. It is designed for low- and mid-priced GSM/GPRS mobile phones.

### SMARTi PM

The world's first CMOS-based radio frequency transceiver for the EDGE standard.

### SMARTi 3G

The world's first radio frequency transceiver to support all six 3G-standard frequencies. It can therefore be used in all UMTS telephones throughout the world. A further advantage: It is manufactured with power-saving and cost-efficient CMOS technology, too.

### DVB-T tuners

Tuner ICs make it possible to receive terrestrial digital television signals. They are used by manufacturers of television receivers and set-top boxes.

### GEMINAX Pro

Energy use, packing density, and line card system costs are all of the greatest importance in the central offices of network providers. GEMINAX Pro has set benchmarks for the ADSL2+ standard.

### VINAX

This chip supports the full VDSL2 specification, thereby permitting the industry's greatest transmission range at a data rate of 100 megabits per second. It can be used in applications for both central offices and individual customers, and is one of the most complex chips ever developed at Infineon.

## Memory Products

### Rapid and innovative in the memory business

With a continually growing product portfolio, we keep abreast of the latest electronics market trends. Infineon's DRAMs feature amongst the lowest power use and the highest speeds in the industry. With the scheduled introduction of 90-nanometer process technology we are securing our competitiveness.

#### The memory business – cyclical and fast-moving

Workstations, desktops, and notebook PCs account for between 50 and 60 percent of the DRAM memory chips manufactured today. Servers and network infrastructure take a further 20 or 30 percent. Consumer electronics and telecommunications are smaller market segments, each using under 10 percent share of DRAM memory chips. Telecommunications, however, is the fastest-growing segment, driven by high volume requirements and memory needs of mobile phones.

Market researchers expect DRAM demand in bits to rise about 50 percent annually over the next few years. Semiconductor manufacturers will meet this growth in demand mainly by introducing more and more advanced production technologies, supplemented by investment in new manufacturing facilities. The memory products sector is thus characterized by high investment, while the growth of supply and demand is subject to strong fluctuations. This leads to enormous price volatility, and to cyclical shifts in revenues and earnings. PC manufacturers configure their models according to memory prices; when memory is inexpensive, PCs are manufactured with high memory capacity, and vice versa.

The latest game console generation is currently the focus of DRAM manufacturers' interest. To display their top-quality graphics, game consoles require the industry's fastest memory products that are developed and manufactured by only a few companies, such as Infineon. The business with game consoles, compared to that with PCs, requires close relationships to the memory suppliers and enjoys relatively stable demand and pricing.

The ever-growing diversity of mobile gadgets such as digital cameras, smart phones, and PDAs increasingly requires memory components with low energy use. Energy-saving memory is, however, also necessary for high-capacity servers and notebook graphics systems,

as a means of keeping heat generation to a minimum when the devices are used at full power. Our DRAM products are outstandingly energy-efficient.

One of the most interesting developments in the semiconductor market has been the rapid growth of the NAND flash memory business. This type of memory can be found in removable storage media such as the Multi-MediaCard, SD Card, Memory Stick, and USB stick, which provide the high memory capacity required in digital cameras and MP3 players. Infineon also provides flash cards of various formats, although currently with relatively low memory densities. We aim to accelerate our innovation in this rapidly growing business in the coming years in order to join the market leaders.

#### Reacting flexibly to market conditions

Innovation and flexibility are key to profitable growth when competing in the memory products market. Infineon is able to use its state-of-the-art production technologies to reduce its memory production costs considerably each year. In June 2005, the Company began the transition to its → **90-nanometer production process** for DRAMs. We have also expanded production capacity of our 300-millimeter technology; here Infineon is operating at the cutting edge with memory products that can be manufactured more economically. In this way, we will strive to ensure that in the future we will continue to increase our productivity in the manufacture of memory components by some 30 percent annually. Furthermore, in February 2005, we introduced a DRAM prototype based on our future → **70-nanometer production process** technology.

We have considerably improved our competitive position in the DRAM market since the mid-1990s. With a current share of 14 percent, we are one of the top four in the worldwide DRAM market. To reach our goal of continual profitable growth, we are aiming to reduce costs further by increasing productivity, and are directing our product

range into market segments that show higher prices and less price fluctuation. We are convinced that, in this way, we will be able to improve the profitability of our memory segment.

In recent years, we have gained a reputation as an innovative supplier of memory products for servers (→ **FB-DIMM**). Up to 30 percent of our memory chips are sold in this computer segment, where we are able to achieve higher and more stable profit margins than with conventional PC modules. Infineon is also a technological leader in graphics memory or → **Graphics RAMs**, which are designed for the highest reading and writing speeds. The early development of the next generation of memory products (→ **DDR3**), and a leading position in the introduction of new memory modules (→ **Micro-DIMM**) constitute two further steps along the path to profitable growth.

We have launched Aeneon as a secondary brand to meet the requirements of a number of PC and notebook manufacturers, particularly in the high-growth PC markets in emerging economies. Working with our distribution partners, we are thus increasingly addressing a highly fragmented customer segment.

**Expansion of development and production**

We began the volume production of memory chips at our 300-millimeter facility in Richmond, Virginia, in September 2005. We will continue to rely on cooperative agreements in the future to expand our production capacity, and to develop new products and processes. In this way, risks and costs can be shared, while projects are given a broader resource and financial base. Our production agreements with Winbond in Taiwan and SMIC in China are both running according to plan. SMIC's new 300-millimeter facility in Beijing commenced operations using our 110-nanometer technology. SMIC is also producing products for us at a 200-millimeter facility near Shanghai. Together with Nanya, we are running the manufacturing joint venture, Inotera Memories, from which Infineon receives half of all manufactured goods. We transferred our 90-nanometer technology to Inotera at the end of 2005. We also expanded our longstanding development collaboration with Nanya: in addition to

our joint development of 90-nanometer technology, and combined activities currently underway on 70-nanometer technology, we will now also work together on 60-nanometer technology.

**Infineon innovations**

**90-nanometer production process**

This production process enables smaller structural sizes. The chip surface is roughly 30 percent smaller than that produced in the current 110-nanometer standard. Infineon is the second DRAM manufacturer to introduce this production technology. Smaller chips mean more chips per wafer and lower production costs. More than 1,000 512-megabit chips can now be sited on a 300-millimeter wafer using 90-nanometer technology.

**70-nanometer production process**

The first prototypes were introduced at the beginning of the 2005 financial year. Volume production is to start in calendar year 2006.

**FB-DIMM**

Latest servers will be equipped with this memory module format (Fully Buffered Dual-Inline Memory Module) by the end of 2005. The required AMB (Advanced Memory Buffer) is a complex logic chip that combines signals and transmits them via data lines to the processor at high speeds. Infineon is the only manufacturer that is able to produce both the memory modules and AMB. The first samples of these modules were shown publicly in spring 2005.

**Graphics RAM**

This memory product, featuring a clock rate of up to 800 megahertz, was designed for the high-end performance segment. The king of DRAM memories is used as working memory by graphics cards and game consoles. Manufacturers of 3D graphics cards and game consoles make the highest demands. Today's computer games, with their photographic realism, smooth image flow, and high refresh rates, require the calculation of several million polygons per second. Graphics memory access therefore needs to run without a hitch.

**DDR3**

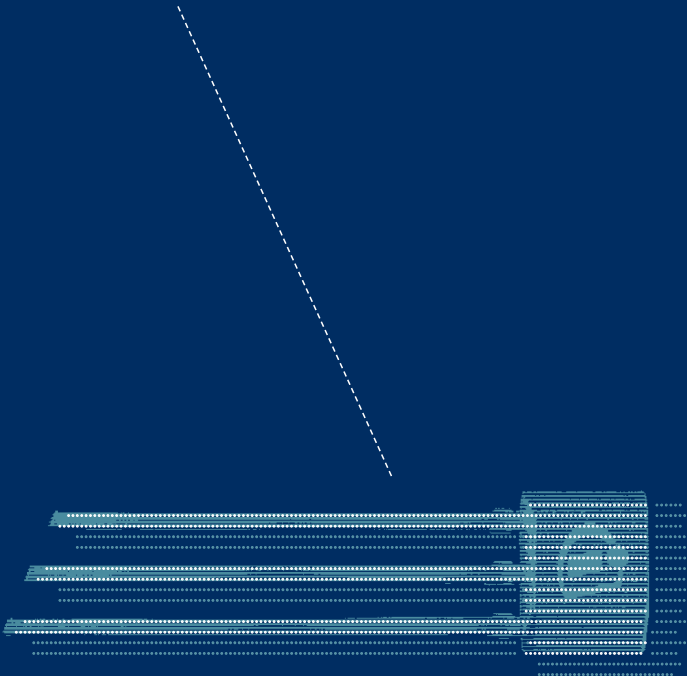
The first memory modules based on the next standard memory generation were shown in 2005. Their market launch is expected in 2007. By 2012, DDR3 will be the mass market product for PCs, notebooks, workstations, and servers.

**Micro-DIMM**

Small memory module format for sub-notebooks.

# HALL SENSOR

To implement the latest concepts in car safety, many physical measurements are required, whether by airbag impact or temperature sensors. Less well-known are the magnetic field sensors which monitor the position of pedals, disks, gear shifts, and switches. Highly accurate measurements are needed for all these functions; this is achieved by our Hall Sensor.



Infineon Technologies Condensed Report 2005

# Condensed financial review



## Condensed operating and financial review

### OVERVIEW OF THE 2005 FINANCIAL YEAR

In our 2005 financial year, which ended September 30, the global economy was generally weaker than in the prior year and the semiconductor market experienced a period of growth moderation. As a global player on the semiconductor market, we were impacted by these unfavorable global economic and market conditions, especially by strong pricing pressure as well as by a decreased demand in our operating segments. In order to address the current challenges in the semiconductor market, we simplified our organization to create shorter and faster decision paths across the entire Company, a stronger customer orientation, as well as greater efficiency and flexibility. We also integrated a number of centralized functions such as sales and manufacturing into the operating segments. In addition, we reached significant milestones in our joint manufacturing ventures and the development of new product technologies.

The following were the key developments in our business during the 2005 financial year:

- ... The Mobile business and Wireline Communication segment were combined into the new Communication segment to align our structure with market developments. At the same time, the security and chip card activities and the ASIC & Design Solutions business were integrated into the extended Automotive, Industrial and Multimarket segment.
- ... Our revenues decreased by 6.1 percent, from €7,195 million in the 2004 financial year to €6,759 million in the 2005 financial year. Our earnings before interest and taxes (EBIT) decreased from positive €256 million in the 2004 financial year to negative EBIT of €183 million in the 2005 financial year.
- ... Our cash flow from operations decreased from €1,857 million in the 2004 financial year to €1,039 million in the 2005 financial year. The reduction was due mainly to decreased gross margin and changes in various current liabilities.
- ... We and ProMOS Technologies Inc. ("ProMOS") reached an agreement regarding ProMOS' license of our previously transferred technologies, pursuant to which ProMOS may continue to produce and sell products using those technologies and to develop its own processes and products. As full consideration, ProMOS agreed to pay us \$156 million in four installments through April 30, 2006. The parties agreed to withdraw their respective claims.
- ... We consummated the acquisition of Saifun Semiconductors Ltd.'s ("Saifun") remaining 30 percent share in the Infineon Technologies Flash joint venture. As part of this acquisition, Saifun granted us a license for the use of Saifun NROM® technologies.
- ... We sold certain assets of our fiber optics business to Finisar Corporation ("Finisar") in exchange for 34 million shares of Finisar's common stock, which were subsequently sold.
- ... We sold our interest in Infineon Ventures GmbH, including the majority of the venture investments held therein.
- ... We and Rambus Inc. ("Rambus") reached an agreement settling all claims between us and providing for a worldwide license to us of the Rambus patent portfolio for use in our current and future memory products.
- ... We agreed upon restructuring measures aimed at reducing costs, downsizing our workforce, and consolidating certain functions and operations. In connection with these measures, restructuring charges of €78 million were recognized during the 2005 financial year.
- ... We recognized impairment charges of €134 million in the 2005 financial year, principally related to our remaining fiber optics businesses, the reorganization measures within our Communication segment and long-term investments.
- ... We continued to invest heavily in research and development and achieved a number of significant milestones during the year, including the introduction of:
  - ... E-GOLDradio, the latest member of our successful E-GOLD family, integrating the complete functionality of our baseband chip, E-GOLDlite, and our sophisticated quadband RF transceiver, SMARTi SD2;
  - ... 90-nanometer DRAM trench technology and demonstration of first functional parts on 70-nanometer DRAM trench technology;
  - ... VINAX, our new VDSL2 chip solution, designed for applications ranging from low-end modems to high-end home gateways;
  - ... SMARTi 3G, the latest member of our successful UMTS transceiver family, designed to be used in mobile applications and supporting currently specified UMTS bands I through VI worldwide;
  - ... a new 8/16/32 bit microcontroller with embedded Flash for use in industrial and automotive applications;



- ... the new space-saving production method FCOS (Flip Chip On Substrate) developed jointly with Giesecke & Devrient GmbH ("Giesecke & Devrient"); and
  - ... a new Trusted Platform Module (TPM), a complete independent hardware and software solution according to the specification of Trusted Computing Group.
- ... As part of our ongoing project to improve our production processes and expand our production capabilities, we:
- ... successfully transferred to different production facilities our high-performance process technology using structure sizes of 130-nanometer for logic products, in order to further increase our production flexibility;
  - ... successfully introduced the 90-nanometer process technology for DRAM products in our 300-millimeter production facility at Dresden;
  - ... expanded the scope of our joint development agreement with Nanya Technology Corporation ("Nanya") to include next generation 60-nanometer DRAM trench technology;
  - ... saw our joint venture Inotera ramp up to approximately 60,000 wafer starts per month several months ahead of schedule;
  - ... saw the 300-millimeter facilities at our plant in Richmond, Virginia, and at our foundry partner Semiconductor Manufacturing International Corporation ("SMIC") in Beijing, China, start commercial production;
  - ... started manufacturing at our memory chip assembly and testing facilities in Suzhou, China;
  - ... started the construction of a new front-end production plant in Kulim High Tech Park, Malaysia, with a total planned investment of approximately \$1 billion. The facility will mainly produce power and logic chips used in automotive and industrial power applications; and
  - ... formed a new development center in Bucharest, Romania, with a principal focus on power ICs including analog and digital functions.

## OUR BUSINESS

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

Following our internal reorganization in the 2005 financial year, our business is organized into three principal operating segments serving various markets in the semiconductor industry:

- ... Our Automotive, Industrial and Multimarket segment designs, develops, manufactures, and markets semiconductors and complete system solutions for use in automotive, industrial, and multimarket applications.
- ... Our Communication segment designs, develops, manufactures, and markets a wide range of ICs, other semiconductors, and complete system solutions for wireline and wireless communication applications.
- ... Our Memory Products segment designs, develops, manufactures, and markets semiconductor memory products with various packaging and configuration options and performance characteristics for standard, specialty, and embedded memory applications.

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

## THE SEMICONDUCTOR INDUSTRY AND FACTORS THAT IMPACT OUR BUSINESS

Our business and the semiconductor industry are highly cyclical and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life

cycles and wide fluctuations in product supply and demand. Although these factors affect all segments of our business, they are especially pronounced in our Memory Products segment, are increasingly true of our Communication segment, and have the least impact on our Automotive, Industrial and 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 overcapacity and oversupply of products, which in turn has led to sharp drops in semiconductor prices. When prices drop, manufacturers have in the past cut back on investing in new fabs. As demand for chips grows over time, without additional fabs coming on line, prices tend to rise, leading to a new cycle of investment. The semiconductor industry has generally been slow to react to declines in demand, due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of planned expansion.

We attempt to mitigate the impact of cyclicality in the memory business by investing in our manufacturing capacities throughout the cycle and entering into alliances and foundry manufacturing arrangements that provide flexibility in responding to changes in the cycle. We believe that we can improve our gross margin in the memory business 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.

### Seasonality

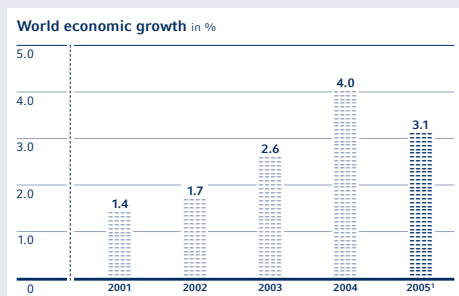
Our business is affected by seasonality, with sales historically stronger in our fourth financial quarter and weaker in our first and second financial quarters. The seasonality of our sales reflects the seasonal demand fluctuations for the products that incorporate our semiconductors. If anticipated 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

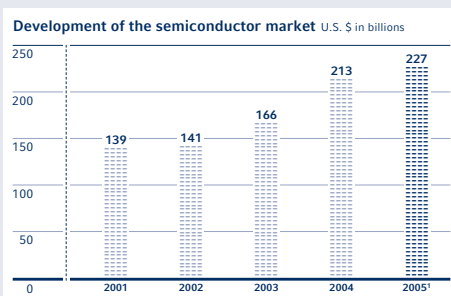
For logic products, the cycle for test, evaluation, and adoption of our products by customers before the start of volume production can range from several months to more than one year. Due to this lengthy cycle, we may experience significant delays from the time we incur expenses for research and development, 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.

### CHALLENGES THAT LIE AHEAD

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



The growth slowdown of the world economy in the 2005 calendar year did not have a positive influence on semiconductor market growth.  
Source: International Monetary Fund; status: September 2005.  
1 Estimated.



Growth slowdown of the semiconductor market in the 2005 calendar year negatively impacted Infineon.  
Source: WSTS; status: October 2005.  
1 Estimated.

## SEMICONDUCTOR MARKET CONDITIONS IN THE 2005 FINANCIAL YEAR

The growth of the semiconductor market weakened significantly during the 2005 calendar year following growth of 28 percent in the 2004 calendar year, according to WSTS (World Semiconductor Trade Statistics). In October 2005, WSTS predicted a growth rate of 7 percent for the 2005 calendar year. According to WSTS, sales in the Asia-Pacific region are expected to increase by 16 percent in the 2005 calendar year. The semiconductor market in Japan is expected to decrease slightly by 3 percent; the European market is expected to remain stable; the North American market is expected to increase slightly by 2 percent. Sales of non-memory products (logic chips, analog, discrete, and optical components), which accounted for 79 percent of the entire market in the first half of the 2005 calendar year, are predicted to grow by 8 percent compared with the 2004 calendar year. Sales of memory products are predicted to grow by 3 percent compared with the 2004 calendar year.

Gartner Dataquest predicts worldwide growth in the 2005 calendar year of 5 percent for semiconductors in the communications business (wireless and wireline). Sales of semiconductors for data processing are predicted to grow by 7 percent, for consumer electronics by 12 percent and for automotive electronics by 7 percent.

## PLANS FOR A NEW SET-UP OF OUR COMPANY

Our key objective is to achieve profitable growth and to maximize value for our shareholders. As such, we regularly consider appropriate steps towards these aims. In furtherance of these goals, and following extensive analysis of our markets and our business, in November 2005 our Supervisory Board approved a plan to restructure our Company in order to better prepare us to exploit market opportunities for our memory products and logic businesses as and when they arise.

The first step in this process will be a transfer of all the assets and liabilities of our Memory Products segment into a separate, wholly owned subsidiary of Infineon (this "drop-down" of assets and liabilities, or "Teilbetrieb", is known as an "Ausgliederung" under German law).

We believe that these reorganization measures will position us quickly to take advantage of appropriate market opportunities for the memory business as and when they arise. We intend to monitor and evaluate financial and industry developments continuously during the 2006 financial year and will consider further reorganization steps as appropriate. It is our Management Board's preferred option to reinforce the market position of the memory products group through an initial public offering (IPO) of shares in the new legal entity. Nevertheless, we have not yet decided on any specific steps following the drop-down of assets and liabilities or any specific timeframe for such steps. We would, over the medium to long term, also consider reducing our position in the current Memory Products group to a minority stake.

## Background

Our business includes both the memory semiconductor activities of our Memory Products segment and the logic semiconductor activities of our two applications segments, Automotive, Industrial and Multimarket, and Communication. The memory and logic sides of our business have historically benefited from certain synergies, but we believe that the two lines of business will diverge in significant respects, reflecting differences in both technological innovation and economics, and that these synergies will therefore decrease. In particular, the memory business continues to be characterized by a highly capital-intensive drive to continuously update and improve manufacturing processes and cost position. The logic business, on the other hand, is shifting into an application/solution-driven model, which requires continuous product development and specialized manufacturing. The intense capital demand of the memory business reflects the need to invest continuously in very costly, efficient and up-to-date fabrication facilities and leading-edge manufacturing technologies. The logic business operates on a smaller manufacturing scale. Certain parts of it (our "advanced logic business" consisting mainly of mobile phone baseband ICs and a range of chip card, wired communication, microcontroller, and other customer-specific ICs) are well-prepared to make use of foundry manufacturing capacity for standard semiconductor manufacturing processes (so-called CMOS technology). Certain other parts of it, mainly our power and RF-IC businesses, can rely on sophisticated, significantly less capital-intensive manufacturing processes mastered

in-house as an important competitive differentiator. In addition, the technologies employed in the two lines of business are expected to increasingly diverge, resulting among other things in differing development roadmaps – with memory disproportionately focused on process technologies – and the need for strategic and development alliances with different partners. The synergies in design methodologies and tools are likewise becoming very limited. Finally, the two lines of business are subject to very different financial market dynamics – which may be less than fully transparent to investors in the combined business.

## RESULTS OF OPERATIONS

### Reorganization

Until the end of the first quarter of the 2005 financial year we were organized into four principal segments, three of which were application-focused – Wireline Communications, Secure Mobile Solutions and Automotive & Industrial; and one of which was product-focused – Memory Products. Beginning with the second quarter of the 2005 financial year, we simplified our organization to create shorter and faster decision paths across the entire Company, a stronger customer orientation, as well as greater efficiency and flexibility. The Mobile business and Wireline Communications segment were combined into the new Communication segment to align the Company's structure with market developments. At the same time, the security and chip card activities and the ASIC &

### Results of Operations expressed as percentages of net sales

For the years ended September 30 <sup>1</sup>	2003	2004	2005
Net sales	100.0	100.0	100.0
Cost of goods sold	(75.0)	(64.9)	(72.6)
<b>Gross margin</b>	<b>25.0</b>	<b>35.1</b>	<b>27.4</b>
Research and development expenses	(17.7)	(16.9)	(19.1)
Selling, general, and administrative expenses	(11.0)	(10.0)	(9.7)
Restructuring charges	(0.5)	(0.2)	(1.2)
Other operating expense, net	(1.4)	(3.6)	(1.4)
<b>Operating income (loss)</b>	<b>(5.6)</b>	<b>4.4</b>	<b>(4.0)</b>
Interest expense, net	(0.8)	(0.6)	(0.1)
Equity in earnings (losses) of associated companies	0.3	(0.2)	0.9
Gain (loss) on associated company share issuance	(0.0)	0.0	0.0
Other non-operating income (expense), net	0.3	(0.9)	0.4
Minority interests	0.1	0.3	0.0
<b>Income (loss) before income taxes</b>	<b>(5.7)</b>	<b>3.0</b>	<b>(2.8)</b>
Income tax expense	(1.4)	(2.1)	(1.8)
<b>Net income (loss)</b>	<b>(7.1)</b>	<b>0.9</b>	<b>(4.6)</b>

1 Columns may not add due to rounding.

Design Solutions business were integrated into the extended Automotive, Industrial and Multimarket segment.

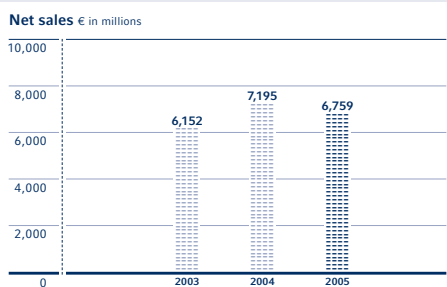
Consequently, we are now organized into three principal segments, two of which are application-focused – Automotive, Industrial and Multimarket, and Communication; and one of which is product-focused – Memory Products. These groups design, develop, manufacture, and market a broad range of semiconductors and complete system solutions used in a wide variety of micro-electronic applications.

The Company reported its results of operations under this new organizational structure starting with the second quarter of the 2005 financial year. The results of operations of all periods presented have been reclassified to be consistent with the revised reporting structure and presentation, as well as to facilitate analysis of current and future operating segment information.

### Net sales

We generate our revenues primarily from the sale of our semiconductor products and systems solutions. In addition, we also generate less than 4 percent of our sales from activities such as foundry services for divested businesses and the licensing of our intellectual property. Our semiconductor products include two main categories of semiconductors:

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



Strong pricing pressure in all segments contributed to the decrease in net sales in the 2005 financial year.

We make the vast majority of our product sales through our direct sales force, with approximately 14 percent of our total revenue in any period derived from sales made through distributors.

We derive our license revenue from royalties and license fees earned on technology that we own and license to third parties. This enables us to recover a portion of our research and development expenses, and also often allows us to gain access to manufacturing capacity at foundries through joint licensing and capacity reservation arrangements. We recognize license income, primarily in the Memory Products segment, resulting from the transfer of technology to our current and former alliance partners, such as Winbond, Nanya, and ProMOS.

Our revenues 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.

For the years ended September 30	2003	2004	2005
<b>Net sales</b>	6,152	7,195	6,759
Changes year-on-year		17 %	(6 %)
of which:			
License income € in millions	183	76	175
% of net sales	3 %	1 %	3 %
Effect of foreign exchange over prior year € in millions	(317)	(445)	(177)
% of net sales	(5 %)	(6 %)	(3 %)
Impact of acquisitions over prior year € in millions	126	29	2
% of net sales	2 %	0 %	0 %

The increase in net sales in the 2004 financial year was mainly driven by higher demand for memory products and semiconductors used in mobile phones, as well as the continued strong performance of the Automotive, Industrial and Multimarket segment. 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. License income decreased in the 2004 financial year mainly as a result of a reduction in license revenues from ProMOS. 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 decline of major foreign currencies (primarily the U.S. dollar) relative to the euro during the 2003, 2004, and 2005 financial years negatively impacted reported sales. The effect of foreign exchange over the prior year is calculated as the estimated change in current year sales if the average exchange rate for the preceding year is applied as a constant rate in the current year. The increase in revenues from entities we acquired since the beginning of the prior year reflects primarily the inclusion of a full-year consolidation of sales in the year after the initial acquisition.

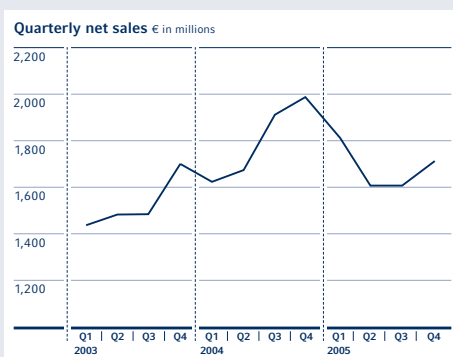
## Net sales by segment

### --- Automotive, Industrial and Multimarket

The segment experienced continued growth in the 2004 financial year as volume growth, particularly for automotive power applications (reflecting the increasing semiconductor content in automotive electronics), more than offset ongoing price pressure caused by technological developments and competition. Increased net sales in the 2004 financial year also resulted from higher volume sales of automotive and industrial products, and from increased demand for chip card and security products. We experienced price pressure in the market for chip card ICs throughout the 2003 financial year, while revenue in the 2004 financial year benefited from a slower rate of price decline. Sales in the 2004 financial year also benefited from the full-year consolidation of SensoNor AS ("SensoNor"), acquired in June 2003, and accelerated growth for industrial applications in the second half of the 2004 financial year. In the 2005 financial year, revenues in this segment decreased slightly compared to the 2004 financial year, despite a continued volume increase in the automotive business. The revenue decline was primarily due to strong pricing pressure combined with decreased market volumes in the security and chip card business.

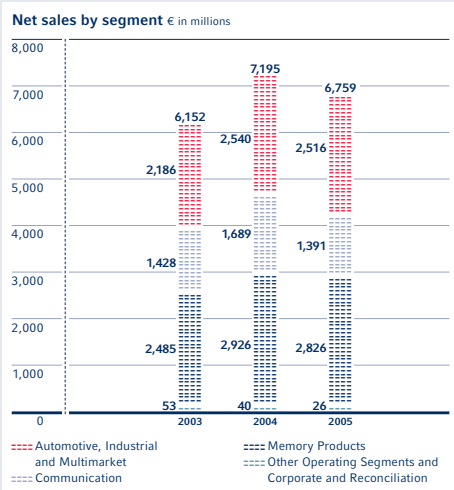
### --- Communication

In the 2003 financial year and the first half of the 2004 financial year, we experienced increasing demand for digital access products as the need for DSL Internet-based communication increased, and markets in developing countries improved. An offsetting trend was the decrease in demand for traditional analog communication products, which was more pronounced in the second half of the 2004 financial year than in prior periods. Sales growth in the 2004 financial year occurred primarily in the second half of the year, as demand for mobile solutions accelerated. In the 2005 financial year, sales in the Communication segment declined year-on-year due to a revenue decrease in the wireless business, primarily caused by a decline in demand from some customers for baseband components beginning in the



Sales increased in the fourth quarter of the 2005 financial year as a result of higher volumes.

For the years ended September 30	2003		2004		2005	
	€ in millions	%	€ in millions	%	€ in millions	%
Automotive, Industrial and Multimarket	2,186	36	2,540	35	2,516	37
Communication	1,428	23	1,689	24	1,391	21
Memory Products	2,485	40	2,926	41	2,826	42
Other Operating Segments	21	—	11	—	12	—
Corporate and Reconciliation	32	1	29	—	14	—
<b>Total</b>	<b>6,152</b>	<b>100</b>	<b>7,195</b>	<b>100</b>	<b>6,759</b>	<b>100</b>

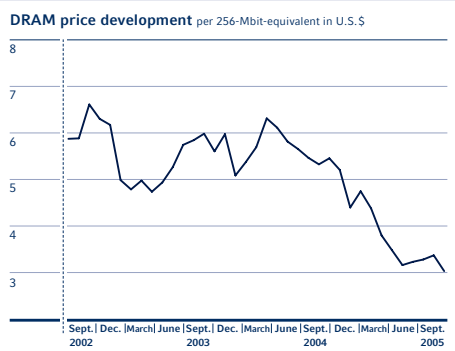


Net sales in our segments were significantly impacted by pricing pressure and the decrease in demand in the wireless communication business.

second quarter of the 2005 financial year, as well as continued pricing pressure. This decline could not be offset by the stable sales trend in the wireline business.

--- Memory Products

The increase in net sales in the 2004 financial year was due mainly to higher volumes, which more than offset the impact of an unfavorable U.S. dollar/euro exchange rate and lower license income. Sales volumes in the 2004 financial year also benefited from the ramp-up of our Dresden 300-millimeter facility, from the conversion to 110-nanometer technology and from access to additional capacity made available through our cooperation with Winbond and SMIC, which offset the reduced volume of products we purchased from ProMOS. Overall megabit volume increased during the 2004 financial year as a result of increasing market demand for personal computers and system memory. Net sales in the 2005 financial year declined compared to the previous year mainly due to price pressure, especially 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-



Source: WSTS

up of our manufacturing joint venture Inotera and the access to additional capacity through our cooperation 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.

The prices in U.S. dollars of both major products DDR and DDR2 memory ICs, declined sharply during the 2005 financial year, especially during the seasonally weaker period between January and April. After April, DDR prices stabilized, whereas DDR2 prices remained under pressure as a result of a supply overhang and slower than expected conversion to DDR2 as mainstream memory. Both contract and spot prices followed a similar trend. Per-bit prices for lower-density SDRAM products declined during the financial year as well, but remained at a higher level compared to DDR and DDR2 due to their legacy character. We plan to diversify our product portfolio and to optimize our product mix to take advantage of market price differentials, and especially increase our focus on products for server, consumer, high-end graphics, and mobile applications, which we believe offer less price volatility and higher margins. Our average per-megabit selling prices for DRAM products declined approximately 27 percent in the 2005 financial year.

### --- Other Operating Segments

Net sales remained relatively unchanged in the 2005 financial year.

### Net sales by region and customer

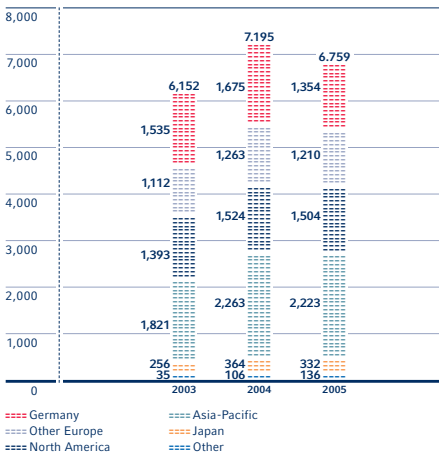
Our sales decreased in the 2005 financial year in all major regions, primarily due to pricing pressure and a lower demand for semiconductor products, especially for baseband components in the wireless business in Germany.

In the Communication segment, we have seen a further consolidation in the industry. In the 2005 financial year, the largest original equipment manufacturers for mobile phones won market share at the expense of

some other manufacturers. With the acquisition of the Siemens Mobile Phone Division by BenQ Corporation ("BenQ"), a Taiwan-based company, we expect that a share of the production volume of one of our largest customers for mobile phone platforms will be shifted to manufacturing sites in Asia and other emerging markets, which have lower production costs. The number of customers of our Automotive, Industrial and Multimarket segment remained stable. In the 2005 financial year, our top 20 customers accounted for nearly 60 percent of that segment's sales. We experienced a shift of revenues from Germany to other European countries, especially to Eastern Europe, in connection with a shift of production facilities of our customers due to lower manufacturing costs in these regions. The number of Memory Product customers increased as we continued to diversify our product portfolio. In the 2005 financial year our top 20 customers accounted for nearly 80 percent of that segment's sales.

The Siemens group accounted for 14 percent, 13 percent, and 13 percent of our net sales in the 2003, 2004, and 2005 financial years, respectively. Sales to the Siemens group comprise both direct sales (which accounted for 13 percent, 13 percent, and 12 percent of net sales, respectively, in those financial years) and sales designated for resale to third parties (which accounted for 1 percent, 0 percent, and 1 percent of net sales, respectively, in those financial years). Sales to the Siemens group are made primarily by our logic application segments. No other single customer accounted for 10 percent or more of our net sales in the 2003, 2004, or 2005 financial years. Effective October 1, 2005, the Siemens Mobile Phone Division was sold to BenQ, a Taiwanese company. Although we still expect Siemens to be one of our largest customers in the 2006 financial year, we do expect that overall sales volumes with Siemens will significantly decline due to the sale of this division.

Net sales by region € in millions



Shift of sales from Germany to other European countries.

Net sales by region

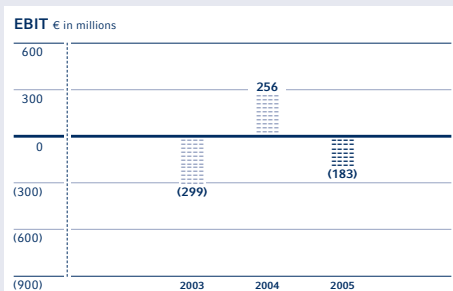
For the years ended September 30	2003		2004		2005	
	€ in millions	%	€ in millions	%	€ in millions	%
Germany	1,535	25	1,675	23	1,354	20
Other Europe	1,112	18	1,263	18	1,210	18
North America	1,393	23	1,524	21	1,504	22
Asia-Pacific	1,821	29	2,263	32	2,223	33
Japan	256	4	364	5	332	5
Other	35	1	106	1	136	2
<b>Total</b>	<b>6,152</b>	<b>100</b>	<b>7,195</b>	<b>100</b>	<b>6,759</b>	<b>100</b>



### 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 millions	2003	2004	2005
Net income (loss)	(435)	61	(312)
Add: Income tax expense	84	154	120
Interest expense, net	52	41	9
<b>EBIT</b>	<b>(299)</b>	<b>256</b>	<b>(183)</b>



Pricing pressure, weaker U.S. dollar/euro exchange rate and other charges had a negative impact on EBIT.

The EBIT amounts of our separate reporting segments were as follows<sup>1</sup>:

For the years ended Sep.30 € in millions	2003	2004	2005
Automotive, Industrial and Multimarket	148	252	134
Communication	(213)	(44)	(295)
Memory Products	31	169	122
Other Operating Segments	(50)	(75)	(4)
Corporate and Reconciliation	(215)	(46)	(140)
<b>Total</b>	<b>(299)</b>	<b>256</b>	<b>(183)</b>

<sup>1</sup> Amounts in prior periods have been conformed to the current year presentation.

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

#### --- Automotive, Industrial and Multimarket

The EBIT improvement in the 2004 financial year was mainly due to higher sales volumes and improved manufacturing efficiency, partially offset by continued pricing pressure. The EBIT decline in the 2005 financial year resulted primarily from the deterioration of the gross margin. As part of that, 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.

#### --- Communication

The EBIT loss decreased in the 2004 financial year, primarily due to lower operating costs, which were partially offset by losses associated with the acquisition of ADMtek. EBIT for the 2004 financial year included goodwill impairments of €71 million related to our Catamaran acquisition. 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.

#### --- Memory Products

The EBIT improvement in the 2004 financial year was primarily due to increased sales volumes and productivity improvements, which offset the impact of the weak U.S. dollar/euro exchange rate, lower license income and antitrust related charges. 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 could not be entirely offset by productivity improvements and increasing license revenue.

### --- Other Operating Segments

The EBIT losses in the 2003 and 2004 financial years mainly reflected investment-related impairment charges. EBIT in the 2005 financial year was positively impacted by a gain of €13 million realized on the sale of our venture capital activities.

### --- Corporate and Reconciliation

The EBIT loss decreased in the 2004 financial year, principally reflecting reduced idle-capacity costs resulting from improved utilization. The 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.

### Interest expense, net

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

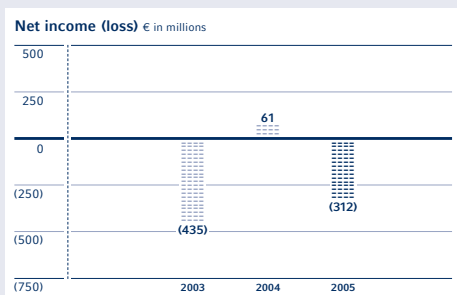
For the years ended September 30	2003	2004	2005
Interest expense, net € in millions	(52)	(41)	(9)
% of net sales	(1%)	(1%)	0%

Interest expense in the 2003, 2004, and 2005 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.

### Income taxes

For the years ended September 30	2003	2004	2005
Income tax expense € in millions	(84)	(154)	(120)
% of net sales	(1%)	(2%)	(2%)
Effective tax rate	(24%)	72%	(63%)

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 2003 financial year we recorded an increase to the valuation allowance of €182 million, which limited the net tax benefit recognized, because we had incurred a cumulative loss in certain tax jurisdictions over the three-year period ended September 30, 2003; however, we continued to record tax expense in profitable tax jurisdictions. In the 2004 financial year, our effective tax rate increased because we recorded additional valuation allowances of €54 million related to tax jurisdictions that continue to have a three-year cumulative loss, and also had more non-deductible expenditures. In the 2005 financial year, as in the 2004 financial year, we continued to have a three-year cumulative loss in certain tax jurisdictions and we recorded an increase to the valuation allowance of €192 million. 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.



Lower net sales and gross margin, as well as restructuring charges contributed to the net loss incurred.

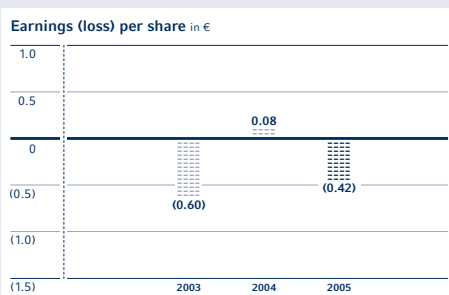
### Net income (loss)

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

### FINANCIAL CONDITION

As of September 30, 2005	2004	2005	% Change year-on-year
€ in millions			
Current assets	5,292	4,574	(14 %)
Non-current assets	5,572	5,710	3 %
<b>Total assets</b>	<b>10,864</b>	<b>10,284</b>	(5 %)
Current liabilities	2,870	2,382	(17 %)
Non-current liabilities	2,016	2,273	13 %
<b>Total liabilities</b>	<b>4,886</b>	<b>4,655</b>	(5 %)
<b>Shareholders' equity</b>	<b>5,978</b>	<b>5,629</b>	(6 %)

As of September 30, 2005, our total assets decreased slightly in comparison to the prior year. Total current assets decreased at the end of the 2005 financial year primarily due to the repayment of a €450 million loan



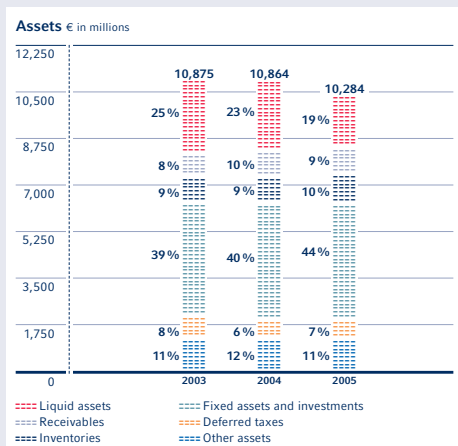
entered into in connection with the build-out of our plant in Dresden.

Non-current assets increased slightly at the end of the 2005 financial year as depreciation, amortization and impairment charges mostly offset capital expenditures and investments in associated companies during the year.

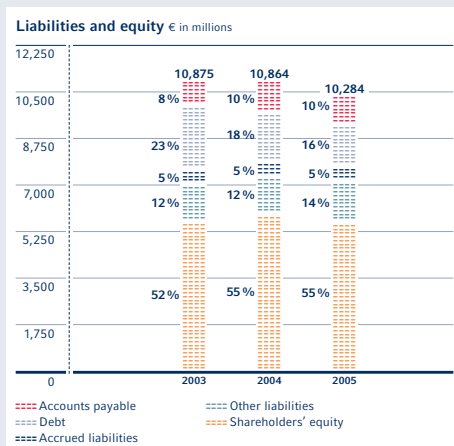
Total liabilities decreased slightly as of the end of the 2005 financial year, mainly due to the net effect of the repayment of a €450 million loan entered into in connection with the build-out of our plant in Dresden which was not entirely offset by long-term debt borrowings of €175 million. The decrease in current liabilities resulted primarily from the repayment of the €450 million loan. Non-current liabilities increased mainly due to long-term debt borrowings of €175 million, used primarily for the financing of R&D projects and manufacturing facilities in Portugal and Austria.

In the 2005 financial year our shareholders' equity decreased principally due to the net loss during the year. At September 30, 2005, shareholders' equity as a percentage of total assets was 55 percent, unchanged from September 30, 2004.

The equity return amounted to negative 5 percent and the return on assets amounted to negative 3 percent in the 2005 financial year, compared to positive 1 percent for both financial ratios in the 2004 financial year. The equity-to-fixed-assets ratio decreased to 150 percent in the 2005 financial year from 167 percent in the prior year as a result of the net loss and capital expenditures



Liquid assets decreased due to the repayment of debt.



Debt decreased due to the redemption of a loan.

which exceeded depreciation expense during the year. The decrease of the debt-to-equity ratio to 30 percent, compared to 33 percent 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.

## LIQUIDITY

### Cash flow

For the years ended September 30 € in millions	2003	2004	2005
Net cash provided by operating activities – continuing operations	731	1,857	1,039
Net cash used in investing activities	(1,522)	(1,809)	(238)
Net cash provided by (used in) financing activities	566	(402)	(266)
Net cash used in operating activities – discontinued operation	(1)	–	–
Cash and cash equivalents at end of year	969	608	1,148

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

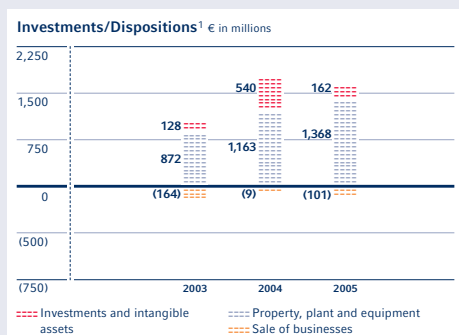
of foreign currency exchange fluctuations and for changes in the scope of consolidation. Therefore, they do not conform to the corresponding changes in the respective balance sheet line items.

Cash provided by operating activities in the 2005 financial year resulted mainly from the net loss of €312 million, which is net of non-cash charges for depreciation of €1,316 million, impairment charges of €134 million, and deferred income taxes of €88 million. Cash

provided by operating activities was positively impacted by a decrease of trade accounts receivable of €119 million. These effects were partly offset by a decrease in accrued liabilities and trade accounts payable of €166 million.

Cash used in investing activities in the 2005 financial year mainly reflects capital expenditures of €1,368 million, principally to equip our plants in Dresden and Richmond, investments of €135 million in associated companies, such as our Inotera joint venture, net sales of marketable securities of €1,082 million, and proceeds from the sale of businesses of €101 million.

Cash used in financing activities in the 2005 financial year principally relates to the repayment of a €450 million loan entered into in connection with the build-out of our plant in Dresden.



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

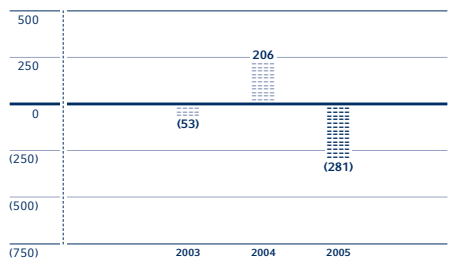
### Free cash flow

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 millions	2003	2004	2005
Net cash provided by operating activities – total	730	1,857	1,039
Net cash used in investing activities	(1,522)	(1,809)	(238)
Purchases (sale) of marketable securities, net	739	158	(1,082)
<b>Free cash flow</b>	<b>(53)</b>	<b>206</b>	<b>(281)</b>

### Free cash flow € in millions



Net cash provided by operating activities could not offset the net cash used in investing activities excluding proceeds from sales of marketable securities.

### Capital expenditures

For the years ended Sep. 30 € in millions	2003	2004	2005
Memory products	576	716	921
Logic products	296	447	447
<b>Total</b>	<b>872</b>	<b>1,163</b>	<b>1,368</b>

Depending on our business situation we expect to invest between €1.2 billion and €1.4 billion in capital expenditures in the 2006 financial year, largely for our manufacturing facilities in Richmond, Virginia, and Kulim, Malaysia. We are also constantly improving productivity and upgrading technology at existing facilities, especially in Dresden, Germany. As of September 30, 2005, approximately €650 million of this amount has been committed and included in unconditional purchase

commitments. Due to the lead times between ordering and delivery of equipment, a substantial amount of capital expenditures typically is committed well in advance. Approximately 50 percent of these expected capital expenditures will be made in the Memory Products segment's front-end and back-end facilities.

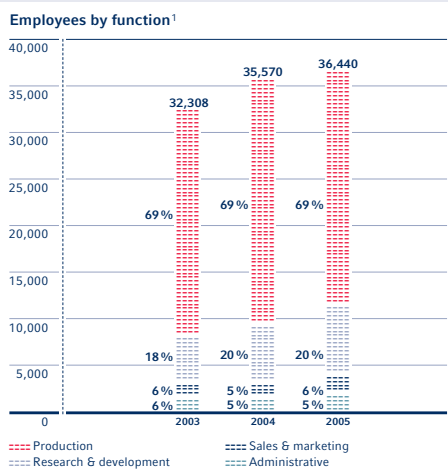
## EMPLOYEES AND CAMPEON

### 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	2003	2004	2005
<b>Function:</b>			
Production	22,405	24,540	25,114
Research & Development	5,935	7,160	7,401
Sales & Marketing	2,048	1,948	2,016
Administrative	1,920	1,922	1,909
<b>Total</b>	<b>32,308</b>	<b>35,570</b>	<b>36,440</b>
<b>Region:</b>			
Germany	16,166	16,387	16,119
Europe	5,034	5,631	5,482
North America	2,757	2,982	3,193
Asia-Pacific	8,116	10,340	11,451
Japan	118	133	158
Other	117	97	37
<b>Total</b>	<b>32,308</b>	<b>35,570</b>	<b>36,440</b>

In the 2004 financial year, our headcount increased principally due to the expansion of manufacturing capacities in Germany, Malaysia and China. In the 2005 financial year, this trend continued in Malaysia and China.



Increase of workforce for the benefit of research and development.  
1 Columns may not add up due to rounding.

### Campeon

We 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, will enable us to centralize most of our Munich-area employees, who are currently situated in various locations throughout Munich, 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 under an operating lease arrangement in October 2005, and have begun the gradual move of our employees to this new location.

### SUBSEQUENT EVENTS

In November 2005, our Supervisory Board approved a plan to transfer the assets and liabilities of our Memory Products segment into a separate, wholly owned subsidiary of our Company (this "drop-down" of assets and liabilities, or "Teilbetrieb", is known as an "Ausgliederung" under German law).

## OUTLOOK

Industry experts forecast mid-single-digit growth for the worldwide semiconductor market in the 2006 calendar year. For the 2006 financial year, we expect to develop at least in line with the market. In our Automotive, Industrial and Multimarket segment, we anticipate further growth due to increasing demand for electronics in cars, power conversion, and energy-saving technologies. In addition, we expect further business opportunities in the Communication segment, mainly due to our capability in radio frequency technologies. In our Memory Products segment, we will continue to focus our portfolio on higher margin growth businesses.

In the first quarter of the 2006 financial year, we expect revenues to increase slightly compared to the fourth quarter of the 2005 financial year. We will continue to phase out the production at Munich-Perlach, to build the new production site in Kulim, Malaysia, and to ramp-up the 300-millimeter production facility in Richmond. In addition, in the first quarter of the 2006 financial year we will begin to recognize stock-based compensation expense in our consolidated statement of operations.

In November 2005, our Supervisory Board approved a plan to separate the memory products business and to form a wholly owned subsidiary of our Company effective July 1, 2006. It is the preferred plan of our management to subsequently move towards a public offering of shares in this business.

For the first quarter of the 2006 financial year, we anticipate the following with respect to our three operating segments:

... In our Automotive, Industrial and Multimarket segment, we expect revenues and EBIT to increase slightly in the automotive and industrial business in the first quarter of the 2006 financial year compared to the fourth quarter of the 2005 financial year, despite annual price reductions at major customers that take effect for the first time in the first quarter of the 2006 financial year. We anticipate revenues and EBIT in the security and chip-card business to remain under pressure, but expect the trend to reverse beginning with the second quarter of the 2006 financial year, due to the cost reduction measures put in place. In the overall Automotive, Industrial and Multimarket segment, we expect revenues to increase slightly and EBIT margin to remain stable compared to the fourth quarter of the 2005 financial year, despite the mentioned price reductions, the anticipated expenses in

connection with the planned phase-out of production at Munich-Perlach, and expenses for the new production site in Kulim, Malaysia.

... In the first quarter of the 2006 financial year, we expect revenues in our Communication segment to remain stable compared to the fourth quarter of the 2005 financial year. We anticipate the segment's EBIT loss to stay in the range of the EBIT loss in the fourth quarter of the 2005 financial year.

... In our Memory Products segment, we expect seasonal strength in demand for computers to drive bit-growth in the DRAM market in the first quarter of the 2006 financial year. On the supply side, capacity and productivity in the industry are expected to grow, offset only partially by capacity shifts to non-DRAM products by some of our competitors. This, coupled with pricing pressure and uncertainties regarding chipset availability in the PC segment, makes price development difficult to predict. We expect to further grow our bit production based on additional capacities at our joint venture Inotera and our 300-millimeter production facility in Richmond. We continue to focus our portfolio on higher margin growth businesses, including infrastructure, and high-end graphics, as well as consumer and mobile applications.

## Consolidated financial statements

### Consolidated statements of operations for the years ended September 30, 2003, 2004, and 2005 € in millions

	2003	2004	2005
Net sales:			
Third parties	5,153	6,169	5,843
Related parties	999	1,026	916
<b>Total net sales</b>	<b>6,152</b>	<b>7,195</b>	<b>6,759</b>
Cost of goods sold	4,614	4,670	4,909
<b>Gross profit</b>	<b>1,538</b>	<b>2,525</b>	<b>1,850</b>
Research and development expenses	1,089	1,219	1,293
Selling, general, and administrative expenses	679	718	655
Restructuring charges	29	17	78
Other operating expenses, net	85	257	92
<b>Operating (loss) income</b>	<b>(344)</b>	<b>314</b>	<b>(268)</b>
Interest expense, net	(52)	(41)	(9)
Equity in earnings (losses) of associated companies	18	(14)	57
Gain (loss) on associated company share issuance	(2)	2	–
Other non-operating income (expense), net	21	(64)	26
Minority interests	8	18	2
<b>Income (loss) before income taxes</b>	<b>(351)</b>	<b>215</b>	<b>(192)</b>
Income tax expense	(84)	(154)	(120)
<b>Net (loss) income</b>	<b>(435)</b>	<b>61</b>	<b>(312)</b>
Basic and diluted (loss) earnings per share in €	(0.60)	0.08	(0.42)



## Consolidated balance sheets as of September 30, 2004 and 2005 € in millions

	2004	2005
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	608	1,148
Marketable securities	1,938	858
Trade accounts receivable, net	1,056	952
Inventories	960	1,022
Deferred income taxes	140	125
Other current assets	590	469
<b>Total current assets</b>	<b>5,292</b>	<b>4,574</b>
Property, plant and equipment, net	3,587	3,751
Long-term investments, net	708	779
Restricted cash	109	88
Deferred income taxes	541	550
Other assets	627	542
<b>Total assets</b>	<b>10,864</b>	<b>10,284</b>
<b>Liabilities and shareholders' equity:</b>		
Current liabilities:		
Short-term debt and current maturities	571	99
Trade accounts payable	1,098	1,069
Accrued liabilities	555	497
Deferred income taxes	16	17
Other current liabilities	630	700
<b>Total current liabilities</b>	<b>2,870</b>	<b>2,382</b>
Long-term debt	1,427	1,566
Deferred income taxes	21	65
Other liabilities	568	642
<b>Total liabilities</b>	<b>4,886</b>	<b>4,655</b>
Shareholders' equity:		
Ordinary share capital	1,495	1,495
Additional paid-in capital	5,800	5,800
Accumulated deficit	(1,200)	(1,512)
Accumulated other comprehensive loss	(117)	(154)
<b>Total shareholders' equity</b>	<b>5,978</b>	<b>5,629</b>
<b>Total liabilities and shareholders' equity</b>	<b>10,864</b>	<b>10,284</b>

**Consolidated statements of shareholders' equity for the years ended September 30, 2003, 2004, and 2005** € in millions, except for share data

	Issued Ordinary shares in shares	Issued Ordinary shares amount
<b>Balance as of October 1, 2002</b>	720,784,218	1,442
Net loss	-	-
Other comprehensive (loss) income	-	-
<b>Total comprehensive loss</b>		
Issuance of ordinary shares:		
Acquisition of Catamaran	96,386	-
Deferred compensation, net	-	-
Other equity transactions	-	-
<b>Balance as of September 30, 2003</b>	720,880,604	1,442
Net income	-	-
Other comprehensive (loss) income	-	-
<b>Total comprehensive income</b>		
Issuance of ordinary shares:		
Settlement of redeemable interest	26,679,255	53
Deferred compensation, net	-	-
<b>Balance as of September 30, 2004</b>	747,559,859	1,495
Net loss	-	-
Other comprehensive income (loss)	-	-
<b>Total comprehensive loss</b>		
Issuance of ordinary shares:		
Exercise of stock options	9,500	-
<b>Balance as of September 30, 2005</b>	747,569,359	1,495

Additional paid-in capital	Accumulated deficit	Foreign currency translation adjustment	Additional minimum pension liability	Unrealized gain/(loss) on securities	Unrealized gain/(loss) on cash flow hedge	Total
5,569	(826)	(5)	(20)	(2)	–	6,158
–	(435)	–	–	–	–	(435)
–	–	(76)	2	13	–	(61)
–	–	–	–	–	–	(496)
1	–	–	–	–	–	1
7	–	–	–	–	–	7
(4)	–	–	–	–	–	(4)
5,573	(1,261)	(81)	(18)	11	–	5,666
–	61	–	–	–	–	61
–	–	(41)	18	(7)	1	(29)
–	–	–	–	–	–	32
225	–	–	–	–	–	278
2	–	–	–	–	–	2
5,800	(1,200)	(122)	–	4	1	5,978
–	(312)	–	–	–	–	(312)
–	–	64	(84)	8	(25)	(37)
–	–	–	–	–	–	(349)
–	–	–	–	–	–	–
5,800	(1,512)	(58)	(84)	12	(24)	5,629

Consolidated statements of cash flows for the years ended September 30, 2003, 2004, and 2005 € in millions

	2003	2004	2005
<b>Net income (loss)</b>			<b>-312</b>
<b>Adjustments to reconcile net income (loss) to cash provided by operating activities:</b>			
Depreciation and amortization	1,437	1,320	<b>1,316</b>
Acquired in-process research and development	6	9	-
Deferred compensation	7	2	-
Provision for (recovery of) doubtful accounts	(16)	15	<b>3</b>
Gain on sale of marketable securities	(56)	(9)	<b>(8)</b>
Loss (gain) on sale of businesses	10	2	<b>(39)</b>
Loss (gain) on disposal of property, plant and equipment	3	(5)	<b>(8)</b>
Equity in (earnings) losses of associated companies	(18)	14	<b>(57)</b>
Loss (gain) on associated company share issuance	2	(2)	-
Minority interests	(8)	(18)	<b>(2)</b>
Impairment charges	98	136	<b>134</b>
Deferred income taxes	16	96	<b>88</b>
<b>Changes in operating assets and liabilities:</b>			
Trade accounts receivable	(227)	(219)	<b>119</b>
Inventories	(112)	(40)	<b>(25)</b>
Other current assets	156	154	<b>(2)</b>
Trade accounts payable	(217)	228	<b>(52)</b>
Accrued liabilities	164	92	<b>(114)</b>
Other current liabilities	(17)	(22)	-
Other assets and liabilities	(62)	43	<b>(2)</b>
<b>Net cash provided by operating activities</b>	<b>731</b>	<b>1,857</b>	<b>1,039</b>

**Consolidated statements of cash flows for the years ended September 30, 2003, 2004, and 2005** € in millions

	2003	2004	2005
<b>Cash flows from investing activities:</b>			
Purchases of marketable securities available for sale	(2,752)	(2,678)	(2,228)
Proceeds from sale of marketable securities available for sale	2,013	2,520	3,310
Proceeds from sale of businesses	164	9	101
Business interests, net of cash acquired	6	(29)	–
Investment in associated and Related Companies	(76)	(386)	(135)
Dividends received from equity investments	–	–	51
Purchases of intangible assets	(58)	(125)	(27)
Purchases of property, plant and equipment	(872)	(1,163)	(1,368)
Proceeds from sales of property, plant and equipment	53	43	58
<b>Net cash used in investing activities</b>	<b>(1,522)</b>	<b>(1,809)</b>	<b>(238)</b>
<b>Cash flows from financing activities:</b>			
Net change in short-term debt	(36)	62	(20)
Net change in related party financial receivables and payables	(76)	75	18
Proceeds from issuance of long-term debt	700	–	192
Principal repayments of long-term debt	(25)	(549)	(500)
Change in restricted cash	3	(43)	21
Proceeds from issuance of shares to minority interest	–	53	23
<b>Net cash provided by (used in) financing activities</b>	<b>566</b>	<b>(402)</b>	<b>(266)</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(4)	(7)	5
Net increase (decrease) in cash and cash equivalents	(229)	(361)	540
Net decrease in cash and cash equivalents from discontinued operation	(1)	–	–
Cash and cash equivalents at beginning of year	1,199	969	608
<b>Cash and cash equivalents at end of year</b>	<b>969</b>	<b>608</b>	<b>1,148</b>

## Financial calendar

### Important financial dates 2006\*

... **Tuesday, January 24**

Publication of first quarter 2006 results

... **Thursday, February 16, 10:00 a.m. CET**

2006 Shareholders' Annual General Meeting in Munich, ICM (Internationales Congress Center München)

... **Wednesday, April 26**

Publication of second quarter 2006 results

\*preliminary

### Forward-looking statements

This condensed 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 the 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.

## Basic share information

Share types	Ordinary registered shares in the form of shares or American Depositary Shares (ADS) with a notional value of €2.00 each (relation ADS:shares = 1:1)
Share capital	€1,495 million (as of Sept. 30, 2005)
Shares outstanding	748 million (as of Sept. 30, 2005)
Listings	Shares: Frankfurt Stock Exchange (FWB) ADS: New York Stock Exchange (NYSE)
Option trading	Options on shares: Eurex Options on ADS: CBOE
IPO	March 13, 2000, on FSE and NYSE
IPO issue price	€35.00 per share \$33.92 per ADS
Ticker symbol	IFX
ISIN code	DE0006231004
CUSIP	45662N103
Bloomberg	IFX.GY (Xetra trading system) IFX.US
Reuters	IFXGn.DE
Index member (selection)	Dax 30 Dow Jones German Titans 30 Dow Jones Stoxx Semiconductor FTSE Euro 100 MSCI Germany SOX S&P Europe 350

## Imprint

**Published by** Infineon Technologies AG, Munich, Germany  
**Editors** Investor Relations, Corporate Communications, Accounting & Financial Reporting

**Copy deadline** November 30, 2005

**Financial year** October 1 to September 30

**Independent** KPMG Deutsche Treuhand-Gesellschaft AG,  
Wirtschaftsprüfungsgesellschaft

**Designed by** häfelinger + wagner design, Munich, Germany

**Photography** Andreas Pohlmann

**Printed by** Kunst- und Werbedruck GmbH & Co. KG, Bad Oeynhausen, Germany

Ordering number B192-H8089-G3-X-7600

Printed in Germany.

The following are **trademarks and/or trade names** of Infineon Technologies AG: Infineon, the Infineon logo, the AENEON logo, FCOS, COOLMOS, OptiMOS, SMARTi, TRICORE and VINAX are registered trademarks of Infineon Technologies AG. E-GOLDlite, E-GOLDradio, GEMINAX Pro, MicroSlim, Mobile-RAM, MP1-G, MultiMediaCard and S-Gold2 are trademarks and/or trade names of Infineon Technologies AG. CellularRAM is a trademark of Micron Technologies, Inc., inside the U.S. and a trademark of Infineon Technologies AG outside the U.S. and is used under license from Micron and Infineon.

The **Bluetooth** trademarks are used by Infineon under license.

All other trademarks used in this condensed report are trademarks or trade names, of which the use thereof by third parties may violate the rights of the respective owners.

## **Infineon Technologies**

If you would like to order copies of the 2005 Annual Report either in German or in English, or if you would like to view these reports and the latest investor information online, please visit us on the Internet at: [www.infineon.com/investor](http://www.infineon.com/investor). Shareholders and other interested investors may also obtain free copies by calling or writing to Investor Relations.

**Headquarters:** Am Campeon 1–12, 85579 Neubiberg/Munich, Germany, Phone +49 (0)89 234-0

**Contact for investors and analysts:**

Investor.Relations@infineon.com, Phone +49 (0)89 234-26655, Fax +49 (0)89 234-26155

**Media contact:**

Media.Relations@infineon.com, Phone +49 (0)89 234-28480, Fax +49 (0)89 234-28482

**Visit us on the Web:** [www.infineon.com](http://www.infineon.com)



Never stop thinking