

Letter to shareholders



Dr. Reinhard Ploss
Chief Executive Officer

Neubiberg, November 2019

*Dear shareholders
and business partners,
dear Infineon colleagues,*

Infineon has been an independent company for 20 years now. During this time, we have matured into a very solid accomplished company with unique technology competencies, full of plans for shaping the future. In the 2019 fiscal year, important directions were set – in terms of strategy, operations, finance and personnel. Without a doubt, the most significant event is the planned acquisition of Cypress, with which Infineon will evolve into a provider of comprehensive and integrated system solutions, in line with our long-term strategy. Equally forward-looking is the construction of our second 300-millimeter plant for power semiconductors in Villach (Austria), for which the groundbreaking took place about one year ago. The acquisition of Silectra is another important element that reinforces our leading technology position in the area of silicon carbide.

Infineon always aligns its entrepreneurial actions to a long-term perspective. Our strategy aims at benefitting from the numerous structural growth drivers in our target markets and being successful throughout economic cycles. The previous fiscal year has illustrated that such cycles are inherent in our business: After a boom phase lasting several years, during which industry growth was mainly limited by available manufacturing capacities, we initially forecast revenue growth of 11 percent. However, geopolitical conflicts and trade tensions cast dark and lasting shadows on the economic outlook at the beginning of the calendar year. Many end-markets experienced a significant slump in demand, and growth momentum was lacking in markets that are important to Infineon:

The automotive industry saw a decline in vehicle sales, the manufacturing industry postponed automation projects and capacity expansions, data center expansions were slowed, end-users held off on purchasing major home appliances. Infineon is not immune to such fluctuations of the world economy, but we stayed our course in an increasingly difficult environment and performed robustly. In March, we had to reduce our revenue target for the year, which we achieved at €8.0 billion. This represents 6 percent more revenue compared to the previous year, which is clearly noteworthy when measured against the development of the semiconductor market as a whole. By way of comparison: The semiconductor association WSTS (World Semiconductor Trade Statistics) expects a decline of semiconductor industry revenues, excluding microprocessors and memory ICs, of 4.2 percent for the 2019 calendar year. Infineon's stringent exposure towards structural growth drivers in the key areas Energy Efficiency, Mobility, the Internet of Things & Big Data as well as Security is paying off. This is particularly evident during weak economic phases: In the previous fiscal year, we were among the very few companies in our industry to increase our revenue in each quarter compared to the corresponding period of the preceding year.

The resilient nature of the business we developed over the last few years is also illustrated by the margin evolution. At 16.4 percent, the Segment Result Margin was approximately half a percentage point below the through-cycle target value, pretty well for a year characterized by a shrinking overall market. The challenge is not so much in the low level of growth itself, but rather in the process of transitioning to such reduced growth levels from the boom phase to which we had oriented our resources. We timely implemented countermeasures and focused on cost management. We put projects to the test, prudently limited increases in employee headcount and, above all, lowered our manufacturing output to curb rising inventory levels. These steps are all a normal part of cycle management, which we will continue to carefully balance with preserving mid-term and long-term growth opportunities: These opportunities are fully intact, and we are ideally positioned to take advantage of them.

The pillars of our strategy with its clearly defined three elements – core activities; growth in adjacent markets; opportunities in new business areas – provide a strong fundament. In the core element, we have mastered the essential technologies, offer a comprehensive product spectrum, and understand the applications of the target markets. A prime example is power electronics for applications in the automotive industry. The element of supplementary growth is built on this, i.e. starting with these competencies we expand into adjacent areas by transferring existing know-how on technologies, products and/or applications and by gaining additional expertise. One such example is variable motor control for industrial applications like factory automation and air conditioners. The third element is innovation for opportunities in new business areas. For example, we use our expertise in sensor technologies to enable more intuitive human-machine-interactions, be it three-dimensional capture with the Time-of-Flight technology, context-sensitive user identification or gesture control based on radar. Our strategic “Product to System (P2S)” approach applies to all three elements of the strategy – core, adjacent and new. Initially the task was to build a deeper system understanding to offer customers components that were better suited to solving their challenges. In the context of shorter and shorter innovation cycles, today and in the future we are enhancing customer value with a complete system offering consisting of seamlessly interoperable, configurable elements, including software, that makes putting together the desired functionalities simple, secure and fast. The performance capabilities of the overall system are increased by functional integration, i.e. consolidation of previously separate sub-functions in a single module (system-in-package) or even on a single chip (system-on-chip), depending on the application. This makes it possible to use smaller form factors and often entails a reduction in power consumption. For the customer this means a simplified design phase, shorter time to market for new products, simplified interoperability and cost savings at the system level.

We intend to accelerate this continuous strategic evolution from a component manufacturer to a provider of system solutions with the planned acquisition of Cypress.

Cypress Semiconductor Corporation was founded in 1982 in San José (USA) and in the years since has become a leading provider of products for automotive and industrial applications and for the Internet of Things. These products include various microcontroller families which are based on the industry-standard Arm® architecture and which can be flexibly programmed with the associated development environment. The second mainstay of Cypress consists of connectivity components, more precisely WiFi and Bluetooth/Bluetooth low energy for wireless and USB/USB-C for wired applications. In addition to this, Cypress offers differentiated memory technologies such as NOR flash, SRAM and F-RAM, which for the most part address special applications. We gained conviction regarding the high level of technological expertise of Cypress from a joint development cooperation we started in early 2018.

How will we benefit from Cypress, what is the rationale behind the largest planned acquisition in the history of Infineon? What are the reasons why we intend to spend approximately €9 billion in economically unstable times?

- › The products and technologies of Infineon and Cypress are highly complementary and define standards in their respective fields. Our power semiconductors, sensors and our microcontrollers for automotive and security applications will be supplemented with connectivity, general purpose microcontrollers for industrial and Internet of Things applications including software, and differentiated memory.
- › Together this will lead to a comprehensive portfolio of complete system solutions. Secure connectivity of energy-efficient devices is the key to success. A wide variety of applications is at the tipping point of growth phases that can be addressed with functional integration.
- › We are moving our strategic P2S approach forward, strengthening and expanding our core through growth in adjacent and new fields. Two examples: The consolidation of Infineon's security expertise with the connectivity know-how of Cypress will accelerate the entry into the field of new industrial Internet of Things applications. The expanded portfolio of microcontrollers and NOR flash memory offers great potential for automotive semiconductors, especially with regard to their growing significance for advanced driver assistance systems and new electronic architectures in the vehicle.
- › The two companies also complement one another in areas other than their product portfolios. This is true of the geographic focus areas and sales channels: Cypress will thus bring Infineon broader market access, in particular in Japan and through distributors. We are expanding our position in Silicon Valley in terms of research and development. With regard to its manufacturing strategy, its product portfolio lets Cypress resort considerably more to outsourcing. The combination will help to deploy our business more broadly and make it more robust.

Together with Cypress, we will be able to address the application spectrum in our target markets in a more comprehensive way. We will be able to offer system solutions needed for connecting the real with the digital world. This strategic rationale is mirrored by financial attractiveness, as we can accelerate our profitable growth. We expect the transaction to have a positive impact on the development of the Segment Result and adjusted earnings per share from the 2021 fiscal year onwards. This entails expected annual cost synergies of €180 million, which are expected to arise by the 2022 fiscal year primarily as a result of scale effects. However, more decisive for value creation are the revenue synergies derived from system thinking, which will be realized through cross-selling and the consolidation of the complementary portfolios into system solutions. We estimate these effects at more than €1.5 billion annually in the long-term. On closing of the acquisition, we will adjust our target operating model. During the integration process, we will leverage more and more of the synergies and meet our targets: By then, we expect revenue growth through the cycle for the larger, combined company to be slightly above our current target rate of 9 percent. The Segment Result Margin is to increase through the cycle from 17 percent to 19 percent. The investment-to-sales ratio will drop through the cycle from 15 percent to 13 percent because of the lower capital intensity of Cypress.

Infineon has grown tremendously in the past few years, and certainly in more respects than just revenue and profit. Approximately five years after buying International Rectifier, we are facing an acquisition easily more than three times larger. We trust that we will succeed, and the outside world puts trust in us. Right now, the Infineon and Cypress teams are intensively preparing the integration, and we are confident regarding pending regulatory approvals and the completion of the transaction around the end of this year. The fact that Infineon is appreciated as a solid trustworthy company also when taking courageous actions has become visible in the steps taken to finance the acquisition: Based on the clear principle of maintaining our investment grade rating, the credit facility for the planned acquisition financing was syndicated within a very short period of time to a consortium of national and international banks. The syndication was significantly oversubscribed, as was the case with the capital increase, where we placed shares with a total value of about €1.5 billion in mid-June. In September, we for the first time issued a hybrid bond, achieving a volume of €1.2 billion. Thus, within only a few months we were already able to refinance approximately one third of the entire transaction. We are very pleased about the support Infineon received from shareholders, bond investors and banks. Broad access to sources of financing is and will remain important to Infineon; at the same time, we are aware of the volatility of financial markets. We are therefore adhering to our strategic liquidity target, are increasing our leverage commensurate with the cash generation of the combined company and are maintaining our dividend policy. Accordingly, we will once again recommend to the Annual General Meeting the payment of a dividend of 27 euro cents per share for the fiscal year ended. Given the higher share count, the total amount to be disbursed would increase from €305 million for the 2018 fiscal year to €336 million.

Continuity and change, this duo characterizes our strategy and our business. We build on what we do well and constantly expand our capabilities. Thus in the short term, we want to hold up well in a still challenging market environment, while taking advantage of medium-term and long-term growth potentials. The economic situation remains tense, and the yet unresolved trade conflicts are a burden. Infineon clearly supports free global trade with low customs tariffs and minimal trade barriers. Accordingly, we hope the protectionist tendencies will not ultimately win out. Until then we will manage everything under our control in order to keep costs tight and to be able to react flexibly when the economic situation begins to recover. However, we expect such recovery for our markets not before the second half of the 2020 fiscal year. This expectation is baked into our outlook, hence we expect revenue growth of 5 percent plus/minus 2 percentage points. At the midpoint of this growth range, the Segment Result Margin should be around 16 percent. We are once again planning on investments of approximately €1.3 billion. Cypress is not yet included in either of these planned figures.

Continuity and change can also describe the past year's personnel developments in the Supervisory and Management Boards. Dr. Eckart Süner took over as temporary Chairman of the Supervisory Board after the 2018 Annual General Meeting. With his extensive experience, he has supported Infineon in this capacity with vigilance and expertise through approximately one and a half very eventful years and has played a particularly decisive role with regard to the Cypress transaction. Mr. Süner will retire from the Board at the conclusion of the 2020 Annual General Meeting for reasons of age. Until then he will remain chairman of the Investment, Finance and Audit Committee and will have been a member of the Infineon Supervisory Board for a total of 13 years. I would like to take this opportunity to express my personal gratitude for this always very close cooperation. The Supervisory Board elected Dr. Wolfgang Eder as its Chairman at its meeting of 6 August 2019. Dr. Eder's entrepreneurial experience and high-profile personality will help shape the future strategic course of the Company, and I look forward to continuing to work together with him. There was also a change in the Chief Financial Officer position. Dominik Asam left the Infineon Management Board as of 31 March 2019 and became Chief Financial Officer at Airbus SE on 1 April 2019. Dominik Asam worked at Infineon in a variety of roles and as a member of the Management Board since his return to Infineon in 2011. With his profound understanding of financial markets, he was able to make an essential contribution to ensuring Infineon's excellent financial position today. I wish Dominik all the best in his new assignment and all the best for his personal future! At the same time, I am very pleased to welcome Dr. Sven Schneider as again a seasoned financial expert, who joined the Management Board team as of 1 May 2019 from Linde AG. Sven Schneider passed his trial-by-fire at Infineon by skillfully mastering the financing of the planned Cypress acquisition. His expertise and personality will help us shape our future path successfully. I myself am also very pleased to continue to help chart this course as CEO in the future. I would like to personally thank the Supervisory Board for placing its confidence in me and extending my contract until 2022. I will continue to serve Infineon with full dedication.

Infineon is developing more than just technology. We have given ourselves a goal and a purpose that will lead us on our way into the future, a journey we have successfully pursued for quite some time. We want to have a lasting impact on creating a more resource-efficient, more connected and more secure future. The next technology generation has to help make more from less in order to make it possible for the growing number of people in the world to live a better life in harmony with nature and thus in harmony with one another. One element is responsible accountability for our actions; developing leading technologies is another. Accepting this challenge and continuing to write our success story is only possible thanks to the enormous dedication, enthusiasm and expertise of our employees, whom I would like to thank personally and in the name of the entire Management Board. Together with our new colleagues from Cypress, we will continue to grow successfully.

Sincerely


Dr. Reinhard Ploss
Chief Executive Officer