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Infineon Technologies AG

## **Annual General Meeting**

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Munich

- the spoken word prevails -

Ladies and Gentlemen,  
Shareholder Representatives,  
Honored Guests and Members of the Press,

Welcome, on behalf of the Management Board, to the sixth Annual General Meeting of Infineon Technologies AG.

The 2005 financial year was a very busy and eventful year for Infineon. Above all, however, it was a year of change: we reorganized the company at the start of 2005; we have reallocated the responsibilities on the Management Board; we have initiated far-reaching restructuring measures; and we have laid the necessary foundations ready to divide the company into two focused businesses. I intend to return to these developments later, but first I would like to report briefly on our performance over the course of the year ended.

### **Results for 2005 financial year**

Overall growth in the semiconductor market slowed markedly in the past year. The growth rate in 2004 reached 28 percent; in 2005 it was just seven percent. Market conditions turned out to be especially difficult for Infineon, as prices in product areas that contribute almost half our sales revenue fell significantly faster than would be expected in a normal year and also significantly faster than prices in the rest of the

semiconductor market. Substantial losses of revenue from one of our most important customers in mobile communications, an area that proved highly fruitful for our competitors in the last year, also set us back.

The first chart shows the average price trend over the last calendar year for memory products, which account for 40 percent of Infineon's sales revenue. The annual price fall in this area in previous years has amounted to around 30 percent, well short of the fall of approximately 50 percent recorded in the period between January and December 2005. The decline in prices was not evenly spread through the year either, but was rather especially pronounced in the first few months. A variety of factors conspired to drive prices down, the most significant being strong growth in production capacities worldwide. Fortunately, according to the market researchers, this growth in capacity will not be repeated in 2006.

These developments combined to prevent us making any gain from the market growth of the semiconductor industry in the fiscal year ended, and our sales revenue was down by six percent year on year to 6.76 billion euros as a result.

Our EBIT also suffered, and we followed our positive figure of 256 million euros in 2004 with a negative figure of 183 million euros for the 2005 financial year.

We could have kept free cash flow neutral by significantly rolling back our investment activities. We believe, however, that the investments in our 300-millimeter production facility in Richmond and in the construction of the plant at Kulim in Malaysia are key to the future of your company: if we wish to reap, we have to be prepared to sow. This, coupled, of course, with the net loss for the year of minus 312 million euros, led to a negative free cash flow of minus 281 million euros. You may recall that we posted a positive free cash flow of 206 million euros in the 2004 financial year.

## **The Infineon share**

This leads me on to our next topic, the performance of the Infineon share.

How has our share price changed since 2004? Not much! Ultimately we have to regard this with disappointment, as the general climate on the stock market has grown far more positive. Our share's lack of movement entirely fails to capture the enormous potential of our products in the marketplace.

Chip shares as a whole profited little from the bullish mood on the stock market in the first half of the year, principally because many semiconductor companies were operating below full capacity and consequently had to revise their profit estimates downward. The Infineon share was not unaffected by this, and in the end underperformed the semiconductor sector as a whole due to the price falls already mentioned and the loss of market share in mobile communication.

Ladies and gentlemen, of one thing let there be no doubt: this price trend is satisfactory neither for us, nor for you as owners of Infineon shares. We have no direct influence on the price of the Infineon share, of course, but our operating performance is down to us. We intend to do everything in our power to improve this operating performance and turn our results around for good.

We have already moved away from a strongly growth-oriented strategy in favor of a strategy for profitable growth, with the emphasis very much on "profitable", and we believe this shift in direction represents the right response for our company at this time.

## **Measures for profitable growth**

What have we done to set the wheels of profitable growth in motion and what have we achieved so far?

We elected to follow a four-step approach.

The first step involved immediately capitalizing on any obvious potential for cutting costs. Projects that appeared to hold little promise were shut down, the venture fund was sold and budgets in the central departments were trimmed. We originally set this “Smart Savings” program a target of slashing 200 million euros off the budget at the time. We eventually ended up saving more than 300 million euros through the program, however, as steadily deteriorating results over the course of the fiscal year forced us to take an even more rigorous approach.

The second step replaced the old function-based organization of the Management Board, which broke responsibilities down into jurisdictions such as sales or production, with an organizational structure based on business segments. This anchored overall responsibility deeper within the company, shortened decision pathways and accelerated processes. The success of this reorganization is already evident: the product creation process, for example, has improved markedly now that the sales and development functions are much closer together, and even more importantly we continue to receive a stream of highly positive feedback from our customers concerning the attitude of our employees and our speed of implementation in projects.

The third step, which ran concurrently with the second, comprised a ruthless analysis of our business units to establish which, if any, needed to be closed or sold and which could be revived. We were careful to consider thoroughly the time and investment involved and the probability of eventual success in each case: this was not the type of rapid slash and burn exercise often perpetrated under the “fix it, sell it or kill it” motto. The results of these analyses led to the sale or closure of the optical fibers, optical networks and base station controllers business units and the end of a

large number of product projects that failed to meet our strict criteria. We also decided to close our plant in Munich-Perlach by the end of the first quarter 2007.

Losing business units gives me no pleasure: in my experience nothing can create value in a company like the rehabilitation of an unprofitable business. A business is quickly destroyed, and once gone it is very hard to reconstruct. Mindful of this we decided to take on the challenges of rehabilitation in a series of critical business units despite the difficulties involved. I can assure you we would never have been prepared to tackle this task were we not confident that we have the right people onboard to make it work.

Our business in baseband processors for mobile telephones provides an excellent example of what can be achieved. Initially enjoying good profitability and good prospects, the unit plunged deep into the red in just a few months as a result of a major loss of sales revenue from our most important customer. This left us with but two options: close the unit and release its 1,200 development engineers, or rapidly attract sufficient new customers to offset the loss in market share in the medium term. We chose the latter path, and thanks to a quite outstanding effort by our employees we succeeded in winning a host of new projects both with existing customers and with significant new customers. The magnitude of this achievement should not be underestimated: this is a market in which mobile telephone producers and semiconductor manufacturers are usually very tightly integrated. You can see the resulting product start-ups on the chart. You will also notice that there is a gap of a year between acquisition and volume production, and as previously indicated it will therefore be four to six quarters before we reach break-even.

Ladies and gentlemen, we have to accept that we are not yet where we want to be in every area and that quite a number of issues still remain to be resolved. The wheels are turning, however, and we have a clear roadmap to follow.

One area in which good progress has already been made is communication. Communication has hit our income statement particularly hard of late, but we have managed to staunch its losses significantly in recent quarters. Cost-cutting measures,

especially in development, have helped, but the biggest contribution has come from Wireline Communications, which has moved back into the black after such a long time as our problem child. EBIT in the communication area as a whole bottomed out at minus 142 million euros in the second quarter of fiscal 2005 – not helped, it has to be said, by one-off restructuring costs – but we were able to trim our losses to minus 46 million euros by the end of the fiscal year. The improvement has continued into the current fiscal year, with losses in the first quarter being reduced to minus 21 million euros.

Our approach has been similar in the second critical area, chip cards. Thanks to a raft of cost-cutting measures aimed at products and processes and a renewed focus on higher grade products, we will reach break-even point in this product area during the fourth quarter. The profitability problem in this business has several causes, not least of which was an unprecedented drop in prices for high volume products of around 40 percent from 2004 to 2005. Productivity measures could not offset such a precipitous decline in the short term.

### **Strategic realignment**

The fourth step in the realignment of Infineon involves separating our organization into one company for memory products and one for logic products and power semiconductors.

Why do we feel the need to do this? Quite simply, because focused companies offer shareholders a clearer profile, adapt better to their customers, give employees a more distinct vision and appear, on the evidence of today's corporate landscape, to be generally more successful.

Please allow me to explore the reasons behind this far-reaching decision in a little more detail. Infineon has previously followed an integrated model combining memory products and logic products: new technologies would initially be introduced for memory products, and the production facilities concerned would then subsequently

be used for logic products and eventually, some years later, for mixed-signal or power semiconductors. Historically this model proved very successful, as it made possible to develop a very strong position in logic products without excessive investment.

Looking to the future, however, we can see that new technologies are now introduced for memory and logic products simultaneously rather than consecutively. The common ground between memory and logic product technologies is steadily diminishing too, so converting a memory production facility into a logic plant is going to grow more and more expensive. Capacity for memory products has to be ramped up to such an extent, moreover, that logic products could never fill the void once memory products have moved on again.

It would have been possible to keep these two business areas together in a holding company of some description despite their highly divergent courses, but this would have denied our shareholders the opportunity to make specific investments in the different businesses. We consequently went for the consistent solution and have opted to establish each business in its own distinct company.

We intend to create a legally independent entity out of the Memory Products business group by July 1, 2006. The new company will initially remain a wholly-owned subsidiary of Infineon with operational headquarters in Munich, but eventual flotation is still our preferred option. Kin Wah Loh, who has been responsible for the business group on the Management Board since end of July of last year, will head up the new company. Nobody knows more about the semiconductor business than Kin Wah Loh: with him at the wheel Memory Products is optimally poised for a bright future as an independent company.

The decision not to give today's Annual General Meeting an opportunity to vote formally on the separation has been a difficult one. The enormous significance of the plans for the company persuaded us at first that we ought to put them to a vote at the Annual General Meeting. The Supervisory Board decision in November was followed, however, by an almost overwhelming chorus of approval not only from shareholders,

but also from our customers, and we subsequently felt it our duty to shareholders to pursue the fastest and most reliable course to implementation of this decision. We are of course keen to let you know all about the project today and will obviously be pleased to answer all of your questions relating to these plans.

The separation will yield two strong and focused companies.

The memory products company, with which I would like to begin, leads the competition in four key areas:

1. We have the best technology. As you will be aware, we are the only manufacturer to use trench technology instead of stack technology for the memory cells. Trench technology has an inherent advantage in terms of electricity consumption, and at current production volumes our products are at least 20 percent better in this respect. The chart shows a thermal image of chips produced using each of these two different technologies. Regions of higher temperatures are identified by brighter colors. The principal driver of growth in the memory products sector are mobile applications, for which reduced electricity consumption is a crucial factor.
2. We have the best chip design. This chart compares the chip sizes of different manufacturers. As you can see, our chips using the established 110-nanometer technology are significantly smaller than the chips produced of our competitors, even those that claim to be using 100-nanometer technology. We have seen chips at the 90-nanometer scale from all of our major competitors including Samsung, Hynix and Elpida, and here too our products are significantly smaller. What this means, in short, is that we are able to fit more chips on a wafer than the competition.
3. We have the largest share of 300-millimeter wafer production across the whole of the sector. This is largely an advantage for the future. Today production can be cheaper from a partially written-off old 200-millimeter facility than from a new 300-millimeter facility because depreciation typically accounts

for almost 50 percent of production costs. Once production hits the 90-nanometer scale and below, however, the 300-mm facilities will have an ever increasing edge over 200-mm plants.

4. We have made major strides in technical development. When the move to 110-nanometer technology came, we were still six months behind the best of our competitors – and it is only against the best that we wish to compare ourselves. We slashed this deficit for 90-nanometer technology, and according to our own estimates are now in second place among DRAM manufacturers. More than half of the developments channeled into our 300-millimeter production facility in Dresden are now on the 90-nanometer scale, and we presented our first samples in 70-nanometer technology during the last fiscal year.

All of this sounds very encouraging, so why do our financial results leave so much to be desired? The reason, as you can see from the next chart, is clear. We are number four for sales revenue in dynamic memory and number two for bit shipments, so plainly we are not sufficiently represented in those market segments and with those customers that offer higher prices.

We have taken all of the available measures to put this right. We have boosted our memory products development activities substantially. We have grown particularly strongly in the area of memory for graphics applications and will continue to do so, and have also identified considerable growth potential for our business in the mobile communication applications segment. We have managed to increase our share of the server market notably, and Mr. Loh has given his creativity full rein in the last few months in pursuit of significant gains for our customer base. These measures, and especially the development of new products, lead in the short term to nothing but increased costs. Financial success comes later, but wise spending now is the way to make this financial success last, and for this reason we will continue to press ahead with the measures described.

Our progress in NAND flash memory continues too. This market is admittedly particularly dynamic at the moment and offers significantly better margins than the DRAM market. We currently have sales revenue in this segment of only somewhat more than 100 million euros, but will be truly competitive only once we introduce 70-nanometer technology in approximately twelve months' time. At present development costs here are almost as high as sales revenues, but once we have the technology in place we will be at the leading edge of this extremely important market.

I would like to conclude my remarks on memory products with this assurance: although the up-front costs involved have so far masked any positive signs in our financial results, I am confident that we are very well set for the future in this sector.

I will now move on to the logic company, or what we might call the "New Infineon" – a company with many strengths and a very good position in a host of important sectors.

Infineon is:

- number one worldwide for power semiconductors,
- number one in automotive electronics in Europe and number two worldwide,
- number one for radio frequency modules for the mobile communication industry,
- number one for chip card and security applications

Our strong position and good results have been overshadowed in the recent past by the severe losses suffered in wireline communications. We have recently finished restructuring this segment, which has now been back in profit for two quarters, and have managed to establish ourselves as technology leader in the field in the process. Unfortunately the problems mentioned have recently afflicted wireless communications and chip cards, and we are now tackling them in this context as I have previously described.

We are especially proud of our success in product development in all areas. The handful of examples I have selected to present today will, I hope, help to substantiate our claim that we have the right products for a multitude of the challenges facing

modern society right across the board, such as increasing energy consumption, increasing mobility combined with the growing need to keep in touch at all times, or elevated security requirements.

Energy is a valuable commodity, and we need to be careful about how we use it. With global energy demand set to continue rising, especially in the newly industrialized countries, it is vital that we improve efficiency at all stages from generation to consumption.

Electronics in general, especially the increased use of power semiconductors, can do much to improve energy efficiency. Infineon's semiconductors can be found at just about every stage in applications ranging from high-voltage DC transmission, energy conversion in wind turbines, propulsion systems for trains and the increasingly popular hybrid drives in automobiles to power supply units for televisions and PCs. We are the world number one in this area.

Spectacular technologies like memories or microcontrollers often overshadow the apparently more mundane world of power semiconductors. Even the most intelligent microcontroller, however, needs power semiconductors to connect it to the real world and we are not only the market leader in this field, but also the leader for technology. One of our most notable power semiconductor technologies is CoolMOS, which can be used to make considerable improvements in the efficiency of power supply units, by way of example. If every PC sold in future would be using CoolMOS technology, one nuclear power station could be saved.

Discussions about saving energy in practice often end up centering on automobiles and especially their drivetrain. The automotive industry has achieved dramatic improvements in fuel efficiency: today's equivalent of a car that would have consumed eleven liters per 100 kilometers in the 1970s requires just five liters per 100 kilometers. Additionally the engine output is now orders of magnitude higher and harmful emissions much lower. The improvement has been made in part thanks to much more complex engine control system algorithms and the advent of the powerful microcontrollers needed to run them. With our new 32-bit controllers of the TriCore

family, we have the most powerful controller on the market, which have carved out a substantial market share.

A moment ago I mentioned society's growing need to keep in touch. Most of you will have a DSL connection at home in order, for example, to be able to follow share prices moment-by-moment. We are currently working on ways to make these connections even faster. That might not sound too exciting at first, but the prospects are genuinely breathtaking: the latest technology, VDSL2 for the experts among you, can carry three HDTV programs simultaneously – all while you continue to surf. Such capabilities will revolutionize our television viewing habits.

You don't have to watch what the programs provide you. You are able to watch whatever you want whenever you want, just by downloading the contents. We are a leader in the VDSL2 technology. And this is not some raw proposition for the future. These lines are already being installed, primarily in Germany but also in other countries, most notably in Japan.

The results for chip cards might be very unpleasant. The future prospects however are bright. Passports, identity cards, health cards, driving licenses – all these cards will contain chips to transfer information more efficiently and to better protect personal data. The magnet strip in your credit card will also be replaced by a chip. In Korea and Japan already today you pay your metro ticket via mobile phone. This phone contains a contactless chip which forwards the information and the trip will be debited directly from your account. We are not only technology leaders in the security card segment. We are also market leaders with a market share that is bigger than the combined market share of the next two competitors.

Let's come to the mobile telephony sector. The semiconductor heart of a mobile telephone consists in simple terms of a baseband processor and a radio frequency transceiver. We are the global market leader for radio frequency transceivers. The world of mobile telephony has grown far more complex in recent years: the GSM and GPRS communication standards were joined by EDGE and then came 3G and variants thereof including the UMTS standard that we use. Launched last year, our

SMARTi 3G is the world's first radio frequency transceiver to support all six frequencies of the 3G standard. This means that it can be used in every UMTS telephone worldwide.

I just have come back from the 3GSM, the world's most important telecommunication trade fair that takes place in Barcelona this week. There was hardly another booth with so many visitors like our booth. And this for a business for which we put into question the right to exist. At the 3GSM we for example presented applications such as TV viewing and 3D games on a mobile phone and a mobile telephone with integral navigation system. The single-chip mobile phones, in which the baseband and radio frequency components are integrated on one chip, produced particular interest. We are technology leader in this area. Markets for these chips are expanding particularly rapidly in newly industrialized countries where the mobile communication network is developing much faster than the fixed network.

Even before its official beginning, the "New Infineon" has already taken one essential decision: we will no longer build our own production facilities for products that require the latest logic processes. We already work together with partners IBM, Samsung and Chartered Semiconductor to develop the technology, and we intend in future to rely on foundries, initially Chartered, for production. This will enable us to scale back our investment in the area substantially, freeing us up to focus our development capabilities on the actual technology and our production operations on those fields in which we can gain a real advantage in the market by manufacturing in-house. The new facility we are building at Kulim in Malaysia, for example, reflects our view that power semiconductors and radio frequency technologies are worth producing in-house. The facility, which will produce logic and power semiconductors for the automotive and industrial electronics sectors, will improve our cost position considerably as well as keeping us at the forefront of the technology.

The corporate vision of the "New Infineon" will thus be very clear: Infineon will become a strong company, in many areas the company, for power semiconductors and analog and mixed-signal modules. This standing will be reinforced by strong positions in specific segments such as embedded control for basebands, platforms

for mobile telephones and automotive applications and also security applications and chip cards. This is the future we envisage from our technology-driven internal perspective. But what will the “New Infineon” look like as a company to outsiders? It will be a leading problem solver, and in many areas the preferred port of call, for issues such as cutting energy consumption and facilitating mobility.

Ladies and gentlemen, both sectors, memory business and logic business, are starting from a strong position, and the freedom to focus on its respective capabilities and requirements will enable each to build and expand on this position in future. A wealth of new opportunities and outstanding potential to open up new markets awaits both units. This, I respectfully submit, is the best of foundations on which to enhance long-term value for you, our shareholders.

### **First quarter results for 2006 and outlook**

Ladies and gentlemen, I turn now to our results for the first quarter of the new fiscal year. Let me confirm without further ado that although logic business has progressed very well and given us several notable successes, the overall result remains unsatisfactory and the trend is negative for both sales revenue and EBIT. Sales revenue fell by three percent quarter on quarter to 1.67 billion euros, and EBIT deteriorated from minus 43 million euros to minus 122 million euros.

This disappointing development results largely from the pronounced fall in prices for memory products. Especially hard hit were DDR2 memory modules, which have been in very limited demand due to the poor availability of corresponding chipsets. Infineon has a particularly large interest in these products, which made the slump in prices all the more painful for us. We responded by scaling back sales in this product segment and directing more of our production to inventory stock in order to prevent a complete price collapse.

As you can see from the chart, the price for DDR2 memory has recovered since the start of January and is now almost back to where it was in September, which has enabled us to reduce our inventories of DDR2 memories back to normal levels.

Ladies and gentlemen, extreme price fluctuations are part and parcel of the memory products business, hence the first quarter trend is nothing unusual. Nevertheless some people have recently been moved to question whether the results in the memory segment will impact on our decision to split this area off. I can assure you that the answer is a definitive no.

Like I already mentioned, the memory products business is known to be volatile. The recent problems in memory products business had more to do with the market environment than with our own operating performance. What matters in a volatile business is to think on the long term – not from month to month or from quarter to quarter, but from cycle to cycle. Our aim at all times has to be to ensure be better in the next cycle than in the cycle before. None of the reasons behind the decision to split off the memory business has changed. We consequently intend to stand by our plans here just as in the logic segment.

I would like to move on now to our outlook for the current quarter. Our predictions include a fall in EBIT in both logic segments, and have as a result already been received with disappointment by some analysts and representatives of the media. We make these predictions not because of any concern about our operating performance, but simply because the second quarter traditionally produces lower sales revenues than the “festive quarter”. It should also be noted here that the price reductions agreed in the annual negotiations usually take effect on January 1, but are not offset by productivity gains until subsequent quarters.

The great dynamism of the semiconductor industry makes it very difficult to offer an outlook for the year as a whole, especially in the memory sector. I would therefore like to limit myself in this regard to disclosing a few trends we have identified for the coming year based on developments thus far. The market research houses predict that the global semiconductor market will grow by somewhere in the medium single

digit area this calendar year, and we expect this trend to be reflected in our current fiscal year.

We anticipate continued growth in the automotive, industrial electronics and multimarket business group this year driven by rising demand for automotive electronics, voltage transformers and energy-saving technologies. Overall we estimate that this year the group will match or possibly even exceed last year's operating margin despite the impact of an 80 million euros charge for the construction of our plant in Kulim and the cost of closing our Munich-Perlach facility.

We expect a positive trend in the communication business group as well. Our optimism here is founded primarily on our impressive radio frequency technology and a firm conviction that we can expand our market share in broadband access solutions and platforms for mobile telephones.

### **Closing remarks**

Ladies and gentlemen, that brings me almost to the end of my presentation here today. I would like to conclude my remarks by reiterating my belief that Infineon made significant strides in the 2005 financial year toward lasting profitability. We cut costs, improved our organization, restructured businesses and started work on separating Infineon into two distinct and clearly focused businesses, one to concentrate on memory products and one to concentrate on logic products.

Our financial results do not reflect the progress we have made, chiefly because of the adverse factors discussed in the memory products market and in mobile communication, but also to an extent because in seeking to turn around our unprofitable businesses, we have striven to give priority to preserving value for you our shareholders rather than taking the easy path to short-term improvements.

Our priorities for the current fiscal year are very the following:

1. We must successfully rehabilitate the remaining loss-making business groups.  
We have stated that we want to reach break-even with the most seriously affected businesses, the communications segment and chip cards, in the fourth quarter of this calendar year. We stand by this target: it is a necessity for the company and a personal goal for me.
2. We want to realize the successful separation of our memory products and logic products businesses.
3. We want to grow faster than the market in the areas I have mentioned in which we are particularly successful.

I would like to close by thanking our shareholders, on behalf of myself and the entire Management Board, for the confidence you have demonstrated in us over the last fiscal year. Thank you too for your patience, which has been put to the test more than once. We deeply appreciate your commitment, and trust that you will continue to support us as we press ahead on our chosen course.

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