

STMICROELECTRONICS NV
Form 6-K
November 22, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

**REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 or 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934**

Report on Form 6-K dated November 22, 2002

**Incorporated by reference in
STMicroelectronics N.V.'s
Registration Statements on Form S-8,
as initially filed with the Commission on October 23, 2000
(File No. 333-12732);
on July 9, 1997 (File No. 333-7226);
and on February 4, 1997 (File No. 333-6390)**

STMicroelectronics N.V.
(Name of Registrant)

**39, Chemin du Champ-des-Filles
1228 Plan-les-Ouates, Geneva, Switzerland
(Address of Principal Executive Offices)**

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of
Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the
information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

Enclosures: STMicroelectronics N.V.'s Third Quarter 2002 Operating and Financial Review and Prospects

STMicroelectronics N.V.
CONSOLIDATED STATEMENT OF INCOME (Unaudited)
(In millions of U.S. dollars, except per share data)

	Three Months Ended		Nine Months Ended	
	September 28, 2002 ⁽¹⁾	September 29, 2001	September 28, 2002 ⁽¹⁾	September 29, 2001
Net sales	\$ 1,632.9	\$ 1,384.5	\$ 4,499.0	\$ 4,865.5
Other revenues	12.3	16.2	32.5	43.5
Net revenues	1,645.2	1,400.7	4,531.5	4,909.0
Cost of sales	(1,036.1)	(938.6)	(2,894.6)	(3,058.6)
Gross profit	609.1	462.1	1,636.9	1,850.4
Selling, general and administrative	(162.7)	(144.2)	(464.1)	(501.1)
Research and development ⁽²⁾	(258.0)	(229.2)	(739.9)	(757.0)
Other income and expenses ⁽²⁾	8.0	(17.2)	(11.4)	10.9
Impairment, restructuring and other related closure costs	(11.6)	(23.3)	(29.6)	(334.6)
Total operating expenses.	(424.3)	(413.9)	(1,245.0)	(1,581.8)
Operating income	184.8	48.2	391.9	268.6
Net interest expense	(20.3)	(4.8)	(51.5)	(1.3)
Equity in loss of joint ventures	(3.8)	(1.2)	(11.0)	(1.2)
Income before income taxes and minority interests	160.7	42.2	329.4	266.1
Income tax expense	(29.0)	(6.2)	(57.9)	(51.8)
Income before minority interests	131.7	36.0	271.5	214.3
Minority interests	(0.5)	(0.2)	(2.7)	(2.2)
Net income	\$ 131.2	\$ 35.8	\$ 268.8	\$ 212.1
Earnings per share (basic)	\$ 0.15	\$ 0.04	\$ 0.30	\$ 0.24
Earnings per share (diluted)	\$ 0.15	\$ 0.04	\$ 0.30	\$ 0.23
Number of weighted average shares used in calculating diluted earnings per share (in millions)	890.3	905.1	893.9	903.3

(1) Results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

(2) Other income and expenses include primarily funds received from government agencies in connection with our research and development programs, the cost of new plant start-ups, as well as foreign currency gains and losses, the gains realized on certain sales of marketable securities, the costs of certain activities relating to intellectual property and miscellaneous revenues and expenses. In 2001, other income and expenses included the amortization of goodwill; from January 1, 2002, with the implementation of FAS 142, goodwill is no longer amortized. Our reported research and development expenses do not include design center, process engineering, pre-production or industrialization costs.

STMicroelectronics N.V.
CONSOLIDATED BALANCE SHEET
(In millions of U.S. dollars)

	As at September 28, 2002 (unaudited)	As at December 31, 2001 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,066.6	\$ 2,438.8
Marketable securities	1,202.2	5.4
Trade accounts receivable	1,016.3	902.4
Inventories	887.3	742.5
Other receivables and assets	543.8	468.5
Total current assets	4,716.2	4,557.6
Goodwill, net	170.8	63.0
Other intangible assets, net	313.0	149.6
Property, plant and equipment, net	5,971.8	5,888.2
Investments and other non-current assets	110.1	139.1
	6,565.7	6,239.9
Total assets	\$ 11,281.9	\$ 10,797.5
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Bank overdrafts	\$ 15.3	\$ 32.8
Current portion of long-term debt	125.4	96.5
Trade accounts payable	823.1	936.1
Other payables and accrued liabilities	481.7	409.5
Accrued and deferred income tax	172.9	212.4
Total current liabilities	1,618.4	1,687.3
Long-term debt	2,797.3	2,771.5
Reserves for pension and termination indemnities	134.4	115.8
Other non-current liabilities	121.4	112.2
	3,053.1	2,999.5
Total liabilities	4,671.5	4,686.8
Commitments and contingencies		
Minority interests	41.0	36.0
Common stock	1,143.1	1,142.4
Capital surplus	1,847.2	1,836.0
Accumulated result	4,431.7	4,198.6
Accumulated other comprehensive loss	(504.3)	(869.0)
Treasury stock	(348.3)	(233.3)
Shareholders equity	6,569.4	6,074.7

Total liabilities and shareholders' equity	\$ 11,281.9	\$ 10,797.5
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STMicroelectronics N.V.
CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)
(In millions of U.S. dollars)

	Nine Months Ended	
	September 28, 2002	September 29, 2001
Cash flows from operating activities:		
Net income	\$ 268.8	\$ 212.1
Add (deduct) non-cash items:		
Depreciation and amortization	1,013.6	972.1
Amortization of discount on convertible debt	65.2	58.9
Impairment and restructuring charges	7.0	334.6
Gain on the sale of marketable securities	(1.4)	(44.8)
Other non-cash items	34.2	(8.2)
Minority interest in net income of subsidiaries	2.7	2.2
Deferred taxes	3.9	(33.9)
Equity in loss of joint ventures	11.0	1.2
Change in assets and liabilities:		
Trade accounts receivable	(74.3)	422.1
Inventories	(64.9)	(8.4)
Trade accounts payable	(44.7)	(379.6)
Other assets and liabilities, net	(67.1)	(11.4)
Net cash provided by operating activities	1,154.0	1,516.9
Cash flows from investing activities:		
Payment for purchases of tangible assets	(770.7)	(1,563.1)
Purchase of marketable securities	(1,200.0)	(1,100.5)
Proceeds from the sale of marketable securities	1.4	63.7
Investment in intangible and financial assets	(34.3)	(109.3)
Payment for purchase of acquisition net of cash received	(308.8)	
Net cash used in investing activities	(2,312.4)	(2,709.2)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	68.1	356.3
Repayment of long-term debt	(134.7)	(206.5)
Decrease in short-term facilities	(17.1)	(19.1)
Capital increase	11.9	26.3
Payments to acquire treasury stock	(115.0)	
Dividends paid	(35.6)	(35.8)
Other financing activities	(0.7)	
Net cash provided (used) by financing activities	(223.1)	121.2
Effect of changes in exchange rates	9.3	(14.6)
Net cash decrease	(1,372.2)	(1,085.7)
Cash and cash equivalents at beginning of period	\$ 2,438.8	\$ 2,295.7
Cash and cash equivalents at end of period	\$ 1,066.6	\$ 1,210.0



STMicroelectronics N.V.

Notes to Interim Consolidated Financial Statements (unaudited)

Description of Business

STMicroelectronics N.V. (the Company) is a global independent semiconductor company that designs, develops, manufactures and markets a broad range of semiconductor integrated circuits (ICs) and discrete devices used in a wide variety of microelectronic applications, including automotive products, computer peripherals, telecommunications systems, consumer products, industrial automation and control systems. According to Dataquest-Gartner Group, the Company was the third largest semiconductor company worldwide in 2001 based on sales.

The Company offers a diversified product portfolio and develops products for a wide range of market applications to reduce its dependence on any single product, application or end market. Within its diversified portfolio, the Company has focused on developing products that leverage its technological strengths in creating customized, system-level solutions with high-growth digital and mixed-signal content.

The Company's products are manufactured and designed using a broad range of manufacturing processes and proprietary design methods. The Company uses all of the prevalent function-oriented process technologies, including complementary metal oxide silicon (CMOS), bipolar and nonvolatile memory technologies. In addition, by combining basic processes, the Company has developed advanced systems-oriented technologies that enable it to produce differentiated and application-specific products, including BiCMOS technologies (bipolar and CMOS) for mixed-signal applications, BCD technologies (bipolar, CMOS and diffused metal oxide silicon (DMOS)) for intelligent power applications and embedded memory technologies. This broad technology portfolio, a cornerstone of its strategy for many years, enables the Company to meet the increasing demand for system-on-a-chip solutions. Complementing this depth and diversity of process and design technology is its broad intellectual property portfolio, which the Company uses to enter into important patent cross-licensing agreements with other major semiconductor companies.

Fiscal Year

The Company's fiscal year ends on December 31. Interim periods are established for accounting purposes on a 13-week basis. In 2002, the Company's first quarter ended on March 30, its second quarter on June 29, its third quarter on September 28 and its fourth quarter will end on December 31.

Basis of Presentation

The accompanying interim consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP), consistent in all material respects with those applied for the year ended December 31, 2001. The interim financial information is unaudited, but reflects all normal adjustments which are, in the opinion of management, necessary to provide a fair statement of results for the interim period presented. The results of operations for the interim period are not necessarily indicative of the results to be expected for the entire year.

Certain prior year amounts have been reclassified to conform to the current year presentation. The interim financial statements should be read in conjunction with the financial statements in the Company's Annual Report on Form 20-F for the year ended December 31, 2001.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, *Business Combinations* (FAS 141), which is applicable for all business combinations initiated after June 30, 2001. This statement eliminates the use of the pooling-of-interests method and provides specific criteria for the recognition of intangible assets apart from goodwill. In the second half of 2001, the Company did not enter into any combination that would require the application of FAS 141. In the first quarter of 2002, the Company completed an asset sale and purchase agreement with Alcatel Business Systems to acquire certain assets dedicated to custom ASICs activities in the mobile phone market; the agreement also included the transfer from Alcatel Business Systems to the Company of a dedicated development team. The purchase price was approximately \$1 million and the value of the workforce transferred was recorded as goodwill by the Company. On June 26, 2002 the Company completed the acquisition of Alcatel Microelectronics, a company of the Alcatel group, which manufactures and markets semiconductor integrated circuits. Concurrently, the Company sold to AMI Semiconductors, Inc. the just acquired mixed signal business activities of Alcatel Microelectronics and also its fabrication facility. The consideration for the purchase of Alcatel Microelectronics net of the proceeds from the resale to AMI was \$308.8 million that has been fully paid as of September 28, 2002. The purchase price allocation is based on a third party independent appraisal and makes reference to the future business assumptions made by management, based on management's best knowledge of the acquired company and the industry. Such assumptions might be revisited as management acquires further knowledge of the acquired company or industry conditions change. The purchase price allocation may therefore be changed slightly in the next nine months. The Company recorded as intangible assets \$110.5 million for core technologies, \$57.7 million as an intangible asset for the supply contract signed with Alcatel group and \$104.0 million as goodwill. In addition, the Company consolidated the fair value of assets and liabilities of entities acquired from Alcatel Microelectronics. As a result of this purchase price allocation, the Company also recorded a charge of \$7.6 million in the second quarter of 2002 for in-process research and development.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (FAS 142), which is effective for fiscal years beginning after December 15, 2001. FAS 142 primarily addresses the accounting that must be applied to goodwill and intangible assets subsequent to their initial recognition. In particular the statement requires that goodwill and indefinite lived intangible assets no longer be amortized but be subject to annual impairment tests to determine the appropriate carrying value. FAS 142 also requires the reclassification of any intangible assets which do not meet the FAS 141 criteria for recognition separately from goodwill. The Company adopted the standards required by this statement in the first quarter of 2002. In connection with the adoption of FAS 142, the Company reclassified \$2.8 million of its intangible assets to goodwill, which had a total carrying value after this reclassification of \$65.8 million at January 1, 2002. In the first quarter of 2002, the Company performed the transitional impairment review required by FAS 142 and determined that no adjustment for impairment loss was required as a result of adopting the standard.

For its existing goodwill and the reclassified intangible assets, the Company will no longer record amortization, as would have been required prior to the adoption of FAS 142. Had FAS 142 not been adopted, excluding impact of businesses acquired during 2002, the Company would have recorded an additional amortization expense of \$12.7 million during the first nine months of 2002. The following table presents the impact of FAS 142 in net income and net earnings per share had the standard been in effect for the nine months ended September 29, 2001 (in millions of U.S. dollars, except per share data):

	Nine Months Ended	
	September 28, 2002 (unaudited)	September 29, 2001 (unaudited)
Net income as reported	\$ 268.8	\$ 212.1
Adjustments:		
Amortization of goodwill		20.5
Amortization of acquired workforce previously classified as intangible assets		1.5
Income tax effect		(0.7)
Net income as adjusted	268.8	233.4
Diluted EPS as reported	0.30	0.23
Diluted EPS as adjusted	\$ 0.30	\$ 0.26

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), which is effective for fiscal years beginning after December 15, 2001.

Long-Lived Assets to be held and used. FAS 144 retains the requirements of Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* (FAS 121) to (i) recognize an impairment loss only if the carrying amount of a long-lived assets is not recoverable from its undiscounted cash flows and (ii) measure an impairment loss as the difference between the carrying amount and fair value of the asset. To resolve implementation issues, FAS 144 removes goodwill from its scope and therefore, eliminates the requirement of FAS 121 to allocate goodwill to long-lived assets to be tested for impairment.

Long-Lived Assets to be disposed of other than by sale. FAS 144 requires that long-lived assets to be abandoned, exchanged or distributed in a spin-off be considered held and used until they are disposed of. FAS 144 requires that the depreciable life of a long-lived asset to be abandoned be revised and also requires that an impairment loss be recognized at the date a long-lived asset is exchanged or distributed in a spin-off if the carrying amount of the assets exceeds its fair value.

Long-Lived assets to be disposed of by sale. The accounting model retains the requirements of FAS 121 to measure long-lived asset classified as held for sale at the lower of its carrying amount or fair value less cost to sell and to cease depreciation (amortization). Therefore, discontinued operations are no longer measured on a net realizable value basis, and future operating losses are no longer recognized before they occur.

The Company adopted FAS 144 during the first quarter of 2002 and determined that no adjustment was required as a result of adopting the standard.

In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (FAS 146), which is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. This statement nullifies Emerging Issues Task Force (EITF) Issue No. 94-3 Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (Issue 94-3). FAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a disposal activity covered by FAS No. 144. Those costs include, but are not limited to, the following:

- One-time termination benefits provided to current employees,

- Costs to terminate a contract that is not a capital lease, and

- Costs to consolidate facilities or relocate employees.

The principal difference between FAS 146 and Issue 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or a disposal activity. FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, a liability being defined as probable future sacrifice arising from present obligations. Under Issue 94-3, a liability for an exit cost as defined in Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. Under FAS 146, an entity's commitment to a plan, by itself, does not create a permanent obligation to others that meets the definition of a liability.

The Company early adopted FAS 146 during the third quarter of 2002, entering a provision of \$0.9 million for severance costs associated with termination of activities in the United States. Had this statement not been adopted during the third quarter of 2002, as previously required by Issue 94-3 the Company would have recorded additional \$0.7 million expenses relating to severance benefits to be paid to employees whose transition period exceeds 60 days. These additional expenses will be booked over the whole transition period.

Impairment, Restructuring and Other Related Closure Costs

In the second quarter of 2001, the Company recorded an impairment charge of \$296.3 million. This charge included impairment losses of (i) \$176.7 million associated with tangible assets at the Company's fabrication sites; (ii) \$97.3 million related to purchased technologies and goodwill on previous acquisitions; and (iii) \$22.3 million for financial assets with an other than temporary decline in value. This impairment charge resulted from a significant deterioration in the business climate in the semiconductor industry. Due to these market changes, the Company revised its production forecasts and foresaw an underutilization of the capacities of certain 150mm fabrication facilities. The fair value for tangible and intangible assets was determined using the discounted expected future cash flows model.

Quoted market values were used in determining the fair value of financial assets. Additionally, in the second quarter of 2001, the Company recorded restructuring charges of \$15.0 million relating to the closure of its facility in Ottawa, Canada. In the third quarter of 2001, the Company recorded an impairment charge of \$23.3 million relating to the building and facilities of its Rancho Bernardo, California, 150mm fabrication plant; this impairment charge was based on quoted market value and resulted from management's decision to close the plant. In the fourth quarter of 2001, the Company recorded expenses of \$10.9 million related to severance costs and retention bonuses for plant employees during the closure of the facilities in Ottawa, Canada, and Rancho Bernardo, California.

The Company recorded expenses of \$29.6 million in the first nine months of 2002 including (i) \$22.0 million relating to decommissioning costs, retention bonuses and contract obligations incurred during the closure of the facilities in Ottawa, Canada, and Rancho Bernardo, California; (ii) \$6.9 million impairment charges for long term investments; and (iii) \$0.7 million for restructuring of the graphics division of the Consumer & Microcontrollers product group. In the third quarter of 2002, the Company recorded expenses of \$11.6 including (i) \$4.7 million relating to decommissioning costs, retention bonuses and contract obligations incurred during the closure of the facilities in Ottawa, Canada, and Rancho Bernardo, California; and (ii) impairment charges for long term investments in SuperH Inc. of \$6.1 million and in Data Play of \$0.8 million. After assessing the fair value of its investment in SuperH, the Company wrote off the remaining investment book value of \$3.5 million. In addition, the Company expensed a \$2.6 million capital increase that it will be contractually obliged to contribute to SuperH, Inc. in the fourth quarter of 2002.

Equity in Loss of Joint Venture

During the third quarter of 2001, the Company and Hitachi Ltd. formed a joint venture, SuperH, Inc., to develop and license RISC microprocessors. The Company is accounting for its 44% share of SuperH, Inc. under the equity method. In the balance sheet, it is included in investments and other non-current assets. At December 31, 2001, the Company's investment totaled \$10.1 million. During the second quarter of 2002 the Company contributed \$4.4 million in cash to a capital increase of SuperH; its 44% share of SuperH, Inc. remained unchanged. The Company recorded a charge of \$11.0 million in the first nine months of 2002.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets consist of the following:

In millions of U.S. dollars	<u>As at September 28, 2002</u>	<u>As at December 31, 2001</u>
	(unaudited)	(audited)
Goodwill	\$ 170.8	\$ 63.0
Other intangible assets	313.0	149.6
Total	\$ 483.8	\$ 212.6

As required by FAS 142 adopted by the Company during the first quarter of 2002, goodwill is no longer amortized. Other intangible assets include the cost of technologies and licenses purchased from third parties, amortized over a period ranging from three to seven years.

The main increase during 2002 is related to the booking of \$104.0 million in goodwill and of \$168.2 million in intangible assets whose average estimated life is five years, both associated with the purchase of Alcatel Microelectronics.

Inventories

Inventories consist of the following:

In millions of U.S. dollars	As at September 28, 2002	As at December 31, 2001
	(unaudited)	(audited)
Raw materials	\$ 58.4	\$ 52.5
Work-in-process	635.6	534.0
Finished products	193.3	156.0
	\$ 887.3	\$ 742.5

The main increase in inventory at September 28, 2002, when compared to December 31, 2001 was recorded in work-in-process, which was due to the increase in the manufacturing activity of fabrication plants.

Cash Equivalents and Marketable Securities

All highly liquid investments purchased with an original maturity of ninety days or less are considered to be cash equivalents.

Management determines the appropriate classification of debt and equity securities at the time of purchase and reassesses the classification at each reporting date. Certain marketable securities, which do not have a readily determinable fair value, are carried at cost. Those marketable securities classified as available-for-sale are reported at fair value with net unrealized gains or losses reported as a separate component of comprehensive income in the statement of shareholders' equity. Other than temporary losses are recorded in net income based on the Company's assessment of any significant, sustained reductions in the investment's market value and of the market indicators affecting the securities. Gains and losses on securities sold are determined based on the specific identification method and are recorded as other income or expense.

At September 28, 2002, \$1.2 billion of Credit Linked Notes/Deposits were recorded as marketable securities. These Credit Linked Notes/Deposits are bank deposits having as underlying assets bonds issued by different banks with a minimum rating of A. Interest on these deposits is paid quarterly and the interest rate is fixed every three months based on the LIBOR rate of the U.S. dollar plus a spread. The final maturity of these deposits is December 30, 2002, date on which the principal will be repaid to the Company. At any time during the period, the Company can ask for the early repayment of these deposits.

Net Interest Loss

	Nine Months Ended	
	September 28, 2002	September 29, 2001
In millions of U.S dollars	(unaudited)	(unaudited)
Income	\$ 36.1	\$ 83.5
Expense	(87.6)	(84.8)
Total	\$ (51.5)	\$ (1.3)

Long-term Debt

Long-term debt consists of the following:

	As at September 28, 2002	As at December 31, 2001
	(unaudited)	(audited)
In millions of U.S. dollars		
STMicroelectronics SA (France)		
• 4.90% bank loan due 2002	\$	\$ 6.7
• 4.88% bank loan due 2002		6.7
• 3.65% bank loan due 2006	149.4	134.4
• 2.72% other bank loans	3.0	6.6
• 4.67% capital lease ⁽¹⁾	27.3	
STMicroelectronics s.r.l. (Italy)		
• 5.68% bank loan due 2002	18.1	32.1
• 5.35% bank loan due 2006	21.9	21.9
• 1.40% other bank loans	58.4	50.4
STMicroelectronics N.V. (Netherlands)		
• 2.44% Liquid Yield Option Notes (LYONs) due 2009	775.4	761.5
• 3.75% Convertible Bonds due 2010	1,586.6	1,543.0
STMicroelectronics Pte (Singapore)		
• 4.00% Bank loan due 2007	169.1	162.2
• 3.50% other bank loans	0.5	0.7
STMicroelectronics (others)		
• 4.55% other bank loans	113.0	141.8
Total long-term debt	2,922.7	2,868.0
Total long-term debt, less current portion	\$ 2,797.3	\$ 2,771.5

(1) In the third quarter of 2002 the Company entered into a capital lease for the building of the Crolles 2 site on which the Company has an option to buy.

Computation of Earnings Per Share

Basic net earnings per share (EPS) is computed based on net income available to common shareholders using the weighted-average number of common shares outstanding during the reported period; the number of outstanding shares does not include treasury shares. Diluted EPS is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period, such as stock issuable pursuant to the exercise of stock options outstanding and the conversion of convertible debt.

	Three Months Ended		Nine Months Ended	
	September 28, 2002	September 29, 2001	September 28, 2002	September 29, 2001
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Basic EPS:				
Net income (in millions of U.S. dollars)	131.2	35.8	268.8	212.1
Weighted average shares outstanding (in millions)	886.4	898.1	887.9	894.2
EPS (basic) (in U.S. dollars)	0.15	0.04	0.30	0.24
Diluted EPS:				
Net income (in millions of U.S. dollars)	131.2	35.8	268.8	212.1
Interest expense on convertible debt, net of tax ⁽¹⁾ (in millions of U.S. dollars)				
Net income, adjusted (in millions of U.S. dollars)	131.2	35.8	268.8	212.1
Weighted average shares outstanding (in millions)	886.4	898.1	887.9	894.2
Dilutive effect of stock options (in millions)	3.9	7.0	6.0	9.1
Dilutive effect of convertible debt (in millions)				
Number of shares used in calculating EPS (in millions)	890.3	905.1	893.9	903.3
EPS (diluted) (in U.S. dollars)	0.15	0.04	0.30	0.23

(1) Due to the level of net income per share, there was no dilutive effect of convertible debt at September 28, 2002.

As of September 28, 2002, basic shares outstanding were 886.4 million.

As of September 28, 2002, there were outstanding stock options for equivalent 47.4 million shares, and 44.1 million shares equivalent for convertible debt.

Treasury Stock

As of December 31, 2001, 9,400,000 of the Company's common shares had been repurchased for a total amount of \$233.3 million and were reflected at cost as a reduction of shareholders' equity. The repurchased shares were designated to fund the Company's most recent employee stock option plan.

During the first quarter of 2002, the Company did not repurchase any of its common shares.

In May 2002, the Company repurchased an additional four million common shares totaling \$115.0 million, in order to fund Company's most recent employee stock option plan. As of September 28, 2002, the Company had repurchased a total of 13.4 million common shares, for a total amount of \$348.3 million.

As of September 28, 2002, none of the common shares repurchased in 2001 and 2002 had been transferred to employees under the employee stock option plan.

Dividend

As approved by the annual general meeting of shareholders on March 27, 2002, the Company paid a cash dividend of \$0.04 per share on April 22, 2002 for a total amount of \$35.6 million.

Legal proceedings

The Company is subject to legal proceedings, claims, and litigations arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Purchase commitments

As of September 28, 2002, the Company had commitments of:

\$411 million for equipment purchases, of which \$244 million for 2002 and \$167 million for 2003;

\$167 million for foundry wafers purchases in 2002, 2003 and 2004; and

\$149 million for software and technologies licenses for 2002 to 2005.

Additional contingent liabilities totaling \$59 million are outstanding for either capital increases or purchase of shares under certain conditions or contribution to expenses, pursuant to the agreements related to the cooperation with Philips Semiconductors International BV and Motorola, Inc. at the Crolles 2 site, the joint ventures with SuperH and Dai Nippon Photomask Europe GmbH and the purchase option for Tioga Technologies Ltd.

Alcatel Microelectronics acquisition pro forma information

Alcatel Microelectronics was acquired on June 26, 2002. The pro forma information below presents the acquisition of Alcatel Microelectronics as of the beginning of the year 2002 and for the comparable prior year period in 2001. Information related to the mixed-signal business and fabrication facilities sold to AMI Semiconductors, Inc. has been excluded. The restructuring costs incurred in 2001 by Alcatel Microelectronics have been excluded and the impact of charges for in-process research and development has been omitted.

Such information is presented by management based on its best knowledge of the acquired company. This is presented for informational purposes only and is not necessarily indicative of the results of future operations or results that would have been achieved had the acquisitions taken place at the beginning of 2001.

Pro forma statement of income (unaudited)

	Three Months ended		Nine Months ended	
	September 28, 2002	September 29, 2001	September 28, 2002	September 29, 2001
In millions of U.S.\$ except per share amounts				
Net revenues	1,645.2	1,428.8	4,571.0	5,095.7
Gross profit	609.1	474.8	1,649.5	1,919.6
Operating expenses	(424.3)	(431.3)	(1,268.2)	(1,646.4)
Operating profit	184.8	43.5	381.3	273.2
Net income	131.2	31.0	255.4	216.0
Earnings per share(basic)	0.15	0.03	0.29	0.24
Earnings per share(diluted)	0.15	0.03	0.29	0.24

As reported statement of income (unaudited)

	Three Months ended		Nine Months ended	
	September 28, 2002	September 29, 2001	September 28, 2002	September 29, 2001
In millions of U.S.\$ except per share amounts				
Net revenues	1,645.2	1,400.7	4,531.5	4,909.0
Gross profit	609.1	462.1	1,636.9	1,850.4
Operating expenses	(424.3)	(413.9)	(1,245.0)	(1,581.8)
Operating profit	184.8	48.2	391.9	268.6
Net income	131.2	35.8	268.8	212.1
Earnings per share (basic)	0.15	0.04	0.30	0.24
Earnings per share (diluted)	0.15	0.04	0.30	0.23

Operating and Financial Review and Prospects

Overview

Our Operating and Financial Review and Prospects is based on our unaudited interim consolidated financial statements found elsewhere in this report, which have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP), and should be read in conjunction with such financial statements.

Critical accounting policies using significant estimates

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the financial statements of assets, liabilities, revenues and expenses and of the disclosures of contingent assets and liabilities accompanying notes to the financial statements. On an ongoing basis, we evaluate our estimates, including those related to volume rebates and price protection, product returns, bad debts, inventories, investments, carrying values of intangible and fixed assets, income taxes, restructuring, pensions, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgment about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates and may affect amounts reported in future periods.

We believe the following critical accounting policies affect our most significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition. Revenues on sales of products are recognized upon transfer of the ownership of the goods, which usually occurs at shipment. A portion of our sales are made to distributors who participate in certain programs common in the semiconductor industry whereby the distributors are allowed to return merchandise under certain circumstances and may receive future price reductions. Provision is made at the time of sale for estimated product returns and price protection, which may occur under the contracts we have with these customers. The provision is based on the latest historical data and expected market prices evolution. If market conditions differ from our assumptions, there could be an impact in future periods; in particular, if the market conditions were to decline, this could result in a reduction of net revenues due to higher returns of products and price reductions at the time these adjustments will occur.

Intangible assets subject to amortization. Intangible assets subject to amortization include the cost of technologies and licenses purchased from third parties, amortized over a period ranging from three to seven years. The carrying value of intangible assets subject to amortization is evaluated whenever changes in circumstances indicate the carrying amount may not be recoverable. In determining recoverability, we estimate the expected undiscounted future cash flows associated with the intangible assets and compare this to the carrying value. Significant estimates used in determining the undiscounted future cash flows include the applicable industry s evolution, our market penetration and the market acceptance of certain new technologies.

Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution and our sales expectations. Future adverse change in market conditions or poor operating results of businesses acquired may require impairment of certain intangible assets.

Goodwill. From January 1, 2002, goodwill acquired in business combinations is no longer amortized and is subject to an annual impairment test to determine the appropriate carrying value. Goodwill subject to potential impairment is determined by comparing the fair value of each reporting unit to which goodwill is allocated and comparing it with the total carrying amount of relevant net assets allocated to such reporting unit. In determining the fair value of reporting unit, we usually estimate the expected discounted future cash flows associated with the reporting unit. Significant estimates used in determining the discounted future cash flows include the applicable industry's evolution, our market penetration and the market acceptance of certain new technologies. Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution and our sales expectations. Future adverse change in market conditions or poor operating results of businesses acquired may require impairment of certain goodwill.

Inventories. Inventories are stated at the lower of cost or market. Cost is computed by adjusting standard cost to approximate actual manufacturing costs on a quarterly basis; the cost is therefore dependent on our manufacturing performances. In the case of underutilization of our manufacturing facilities, the undercapacity cost is not included in the valuation of inventories but charged directly to cost of sales. Provisions are estimated for uncommitted inventories based on order backlog and the previous quarter's sales. To the extent that future negative market conditions generate order backlog cancellation and declining sales, this would require additional inventory write-down charges, negatively impacting cost of sales.

Property, plant and equipment. The carrying value of tangible assets is evaluated whenever changes in circumstances indicate the carrying amount may not be recoverable. In determining recoverability, we estimate the expected future cash flows associated with the property, plant and equipment and compare this to the carrying value. Significant estimates used in determining the undiscounted future cash flows include the industry evolution, the utilization of our fabrication facilities and the ability to upgrade such facilities, changes in selling price and the adoption of new technologies. Any impairment is determined by comparing the carrying value of a tangible asset to the fair value estimated from its expected future cash flows. Our evaluations are based on financial plans updated with the latest projections of the semiconductor market and of our sales expectations, from which we derive the future production needs and loading of our manufacturing facilities; these plans are highly variable due to the high volatility of the semiconductor business and therefore subject to continuous modifications. If the future evolution will differ from the basis of our plans, both in terms of market evolution and production allocation to our manufacturing plants, this could require a further review of the carrying amount of our tangible assets for potential impairment.

Patent and other intellectual property litigation. We have from time to time received, and may in the future receive, communications alleging possible infringements of patents and similar intellectual property rights of others. We constantly monitor, with the support of our outside attorneys when deemed necessary or advisable, the chances of such intellectual property claims being successfully asserted. We will record a provision when we estimate that the claim could successfully be asserted in a court of law, and in the absence of a valid offset or counterclaim. In the event of litigation, which is adversely determined with respect to our interests, or in the event we need to change our evaluation of a potential third party intellectual property claim, based on new evidence or communications, this could have a material adverse effect on our results of operations or financial condition at the time it were to materialize.

Business Outlook

The semiconductor industry experienced very difficult business conditions in 2001, registering the worst downturn in its history. During the first nine months of 2002 uncertain market conditions continued, with the semiconductor market experiencing a further decline compared to the corresponding period of 2001. The total available market is defined as TAM, while SAM, the serviceable available market, is defined as the market for products produced by us, which consists of the TAM excluding PC motherboard major devices such as microprocessors and their peripherals, random access memories (RAMs), read-only memories (ROMs) and semi-custom and discrete segments such as the small signal transistor market and optoelectronic devices. According to preliminary estimates, the TAM was estimated at \$103 billion and the SAM at \$58 billion for the first nine months of 2002, a decrease of approximately 4.9% and 5.1%, respectively, compared to the first nine months of 2001. In 2001, the TAM was \$139 billion, while the SAM was \$78 billion. In the third quarter of 2002 there was a sequential increase in revenues compared to the second quarter of 2002 of approximately 8.2% for the TAM and of approximately 9.5% for the SAM.

During the third quarter of 2002 there was a sequential increase of 7.5% in our net revenues to \$1,645.2 million from \$1,531.1 million registered in the second quarter of 2002; organic growth represented a sequential revenue increase of approximately 4.5% with the acquisition of Alcatel Microelectronics accounting the additional 3%. Our unique balance of targeted market segments enables us to benefit from higher demand in certain key applications and maintain stable gross margin levels, despite the difficult industry conditions, which persisted during the period. We continued to enjoy a high degree of operating leverage, posting 25% increases in both operating income and net income, on a 7.5% sequential revenue gain.

As noted in our earnings release for the second quarter of 2002, our capital expenditures for this year should be approximately \$1 billion, providing the resources to advance strategic investments, research and new product development projects. The pace of the economic and industry recovery is still uncertain, which leads us to adopt a cautious approach to 2003. At this point, we expect our 2003 capital expenditures to be of similar magnitude to 2002 levels. However, our proven modular investment programs and our relationships with foundry partners, provide us with significant operating flexibility, which complements our investment strategy.

We share the view with other semiconductor companies that the traditional fourth quarter seasonal upturn in demand will be quite modest this year. We do expect, however, that we will be able to post sequential revenue growth in the mid single-digit range for the fourth quarter of 2002, driven by increasing end market demand for telecom and automotive applications as well as an increase in revenues from flash memory products. Gross margin is likely to remain stable within the 37%-38% range.

Other Developments

In February 2002, we announced the acquisition of the intellectual property of Tioga Technologies Ltd. for Digital Subscriber Line (Xdsl) chipsets for approximately \$10 million. We also signed an option agreement with Tioga Technologies Ltd. that provide us with a call option to merge Tioga Technologies Ltd. with one of our wholly owned subsidiaries for an additional \$12 million; this call option shall commence on the closing of the deal and continue until January 15, 2003. The option agreement also grants Tioga Technologies Ltd. a put option to cause us to merge Tioga Technologies Ltd. with one of our wholly owned subsidiaries. This put option is exercisable from January 16 through January 31, 2003.

In early May 2002, we repurchased four million common shares totaling \$115.0 million, in order to fund further stock option grants under our most recent employee stock option plan.

In March 2002, we announced an agreement with Royal Philips Electronics and Taiwan Semiconductors Manufacturing Company Ltd. (TMSC) for the joint development of advanced process technologies at the 300mm wafer fabrication facility site known as Crolles 2 in our Crolles, France, research and development center. In April, we announced that Motorola had signed a memorandum of understanding to join this partnership. On June 30, 2002, we signed a cooperation agreement with Philips Semiconductors International BV and Motorola, Inc., for the setting-up of a state of the art 300mm pilot line for advanced research, process integration and manufacturing activities at Crolles 2.

At our Annual General Meeting held on March 27, 2002, shareholders approved all the proposed resolutions, including:

- the re-appointment of the current Supervisory Board Members for a three-year term,
- the re-appointment of Mr. Pasquale Pistorio to a three-year term as our President and Chief Executive Officer, and
- the distribution of a cash dividend of \$0.04 per share, consistent with the prior year's cash dividend payment.

On June 26, 2002 we paid approximately \$1.8 million to obtain a 19% interest of a company established with Dai Nippon Printing to build and operate a photomask production facility next to our manufacturing facility in Agrate, Italy, which is expected to start operations around the middle of 2003.

On June 26, 2002, we finalized the acquisition of the semiconductor chip-manufacturing unit, Alcatel Microelectronics, from Alcatel for approximately \$377 million, subject to final adjustments. This transaction includes an agreement to cooperate on the joint development of DSL chip-sets that will also be made available to the open market. The new agreement calls for us to become a preferred supplier of Alcatel, thus expanding our long-standing strategic alliance. Simultaneously with this acquisition, we signed an agreement with Idaho-based AMI Semiconductors Inc. for the sale of the just acquired mixed signal business activities of Alcatel Microelectronics for approximately \$68 million. This second transaction includes Alcatel Microelectronics' fabrication facilities located in Oudenaarde, Belgium, approximately 1,000 employees and the associated process technologies.

On July 30, 2002, we were informed that France Telecom, one of our indirect shareholders, had finalized the private placement to institutional investors of euro 442.2 million of 6 3/4% notes due August 2005, mandatorily exchangeable into existing common shares of STMicroelectronics N.V. France Telecom announced that the notes are exchangeable for shares from January 2, 2004 and that the number of shares that France Telecom will deliver to the holders of the notes is a maximum of 26.42 million shares and a minimum of 20.13 million shares depending on the price of our shares at maturity.

Results of Operations

The table below sets forth information on our net revenues by product group, by location of order shipment, by customers' region of origin, by application, and by product family:

	Three Months Ended		Nine Months Ended	
	September 28, 2002	September 29, 2001	September 28, 2002	September 29, 2001
In millions of U.S. dollars				
Net Revenues by Product Group:				
Telecom, Peripheral & Automotive	\$ 816.3	\$ 682.8	\$ 2,203.3	\$ 2,318.5
Discrete and Standard Ics	282.7	207.6	767.9	723.9
Memory Products	252.5	275.5	733.7	1,099.0
Consumer & Microcontrollers	267.4	210.8	754.6	682.0
New Ventures Group and Others ⁽¹⁾	26.3	24.0	72.0	85.6
Total	\$ 1,645.2	\$ 1,400.7	\$ 4,531.5	\$ 4,909.0
Net Revenues by Location of Order Shipment⁽²⁾				
Europe	\$ 469.2	\$ 414.6	1,311.7	1,727.7
North America	242.2	273.9	670.6	906.4
Asia Pacific	701.5	558.0	1,969.9	1,715.9
Japan	84.6	67.0	194.3	285.2
Emerging Markets	147.7	87.2	385.0	273.8
Total	\$ 1,645.2	\$ 1,400.7	\$ 4,531.5	\$ 4,909.0
Net Revenues by Customers' Region of Origin⁽²⁾				
Europe	\$ 711.7	\$ 710.9	\$ 1,934.2	\$ 2,486.8
North America	532.3	398.0	1,501.5	1,428.5
Asia Pacific	211.1	152.3	608.5	453.3
Japan	143.7	111.2	358.3	466.4
Emerging Markets	46.4	28.3	129.0	74.0
Total	\$ 1,645.2	\$ 1,400.7	\$ 4,531.5	\$ 4,909.0
Net Revenues by Application:				
Automotive	\$ 222.4	\$ 159.0	\$ 590.8	\$ 529.7
Consumer	337.0	278.5	961.0	957.4
Computer	353.4	294.0	1,023.6	1,045.2
Telecom	499.7	497.2	1,341.1	1,664.2
Industrial & Others	232.7	172.0	615.0	712.5
Total	\$ 1,645.2	\$ 1,400.7	\$ 4,531.5	\$ 4,909.0
Net Revenues by Product Family:				
Differentiated Products	\$ 1,143.0	\$ 974.3	\$ 3,154.3	\$ 3,189.5
Standard & Commodities	95.1	81.9	266.8	268.2
Micro & Memories	204.2	202.3	565.4	940.8
Discretets	202.9	142.2	545.0	510.5
Total	\$ 1,645.2	\$ 1,400.7	\$ 4,531.5	\$ 4,909.0

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- (1) Includes revenues from sales of subsystems and other products and from the New Ventures Group, which was created in May 1994 to act as a center for our new business opportunities.
- (2) For revenues classified by location of order shipment, products ordered by U.S.-based companies to be invoiced to Asia Pacific affiliates are classified as Asia Pacific revenues. For revenues classified by customers' region of origin, products ordered by U.S. based companies to be invoiced to Asia Pacific affiliates are classified as North America revenues.

The table below sets forth a breakdown of operating income by product group:

	Three Months Ended September 28, 2002	Nine Months Ended September 28, 2002
In millions of U.S. dollars		
Operating Income by Product Group		
Telecom, Peripheral & Automotive	\$ 154.7	\$ 433.5
Discrete and Standard Ics	39.9	994
Memory Products	(8.0)	(3.7)
Consumer & Microcontrollers	18.5	38.5
Others ⁽¹⁾	(20.3)	(175.8)
Total	\$ 184.8	\$ 391.9

(1) Includes such items as start-up costs and other unallocated expenses including: strategic (or special) research and development programs, certain corporate level operating expenses, restructuring charges, and other costs that are not allocated to product groups, as well as the revenues and operating earnings or losses of the New Ventures Group and the Subsystems Products Group. The information set forth above has been derived using the accounting policies described in our annual consolidated financial statements contained in our annual report on form 20-F filed on May 24, 2002.

The following table sets forth certain financial data from our consolidated statements of income, expressed in each case as a percentage of net revenues :

	Three Months Ended		Nine Months Ended	
	September 28, 2002	September 29, 2001	September 28, 2002	September 29, 2001
Net sales	99.3%	98.8%	99.3%	99.1%
Other revenues	0.7	1.2	0.7	0.9
Net revenues	100.0	100.0	100.0	100.0
Cost of sales	(63.0)	(67.0)	(63.9)	(62.3)
Gross profit	37.0	33.0	36.1	37.7
Operating expenses:				
Selling, general and administrative	(9.9)	(10.3)	(10.2)	(10.2)
Research and development	(15.7)	(16.4)	(16.3)	(15.4)
Other income and expenses	0.5	(1.2)	(0.3)	0.2
Impairment, restructuring and other related closure costs	(0.7)	(1.7)	(0.7)	(6.8)
Total operating expenses	(25.8)	(29.6)	(27.5)	(32.2)
Operating income	11.2	3.4	8.6	5.5
Net interest expense	(1.2)	(0.3)	(1.1)	(0.1)
Equity in loss of joint ventures	(0.2)	(0.1)	(0.2)	
Income before income taxes and minority interests	9.8	3.0	7.3	5.4
Income tax expense	(1.8)	(0.4)	(1.3)	(1.0)

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Income before minority interests	8.0	2.6	6.0	4.4
Minority interests			(0.1)	(0.1)
Net income	8.0%	2.6%	5.9%	4.3%

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Third Quarter 2002 vs. Third Quarter 2001

During the third quarter of 2002, according to preliminary estimates, the semiconductor industry experienced an increase in revenues of approximately 20.6% for the TAM and of approximately 23.5% for the SAM, compared to the third quarter of 2001. Our net revenues in the third quarter of 2002 increased 17.5% compared to the third quarter of 2001.

Net revenues. Net revenues increased 17.5%, from \$1,400.7 million in the third quarter of 2001 to \$1,645.2 million in the third quarter of 2002. Net sales increased 17.9%, from \$1,384.5 million in the third quarter of 2001 to \$1,632.9 million in the third quarter of 2002. Compared to the third quarter of 2001, the increase in our net sales in the third quarter of 2002 was due to higher volume, which was largely offset by a significant decline in average selling prices. Other revenues, consisting primarily of co-development contract fees, certain contract indemnity payments and patent royalty income, decreased from \$16.2 million in the third quarter of 2001 to \$12.3 million in the third quarter of 2002. This was primarily due to a decrease in revenues from co-development contract services.

The Telecom, Peripheral and Automotive Group's net revenues increased 19.6% compared to the third quarter of 2001 primarily as a result of volume increases in sales of automotive/audio, printers, wireless and wireline products that more than offset price decreases for the digital and analog, and data storage products. The Discrete and Standard ICs Group's net revenues increased 36.2% due to volume increases in sales of transistors, discrete and standard commodities products although there was price pressure on the Group's entire product range. The Memory Products Group's net revenues decreased 8.3% as a result of a significant price decline in Flash and EPROM products not fully offset by volume increase of EEPROM products. The Consumer and Microcontrollers Group's net revenues increased 26.9% mainly due to significant volume increases in sales of DVD, display and TV, and microcontrollers products, partially offset by decreasing prices.

During the third quarter of 2002, we maintained our focus on differentiated ICs, which accounted for 69.5% of our net revenues, compared to 69.6% in the third quarter of 2001. Such products foster close relationships with customers, resulting in early knowledge of their evolving requirements and opportunities to access their markets for other products. Analog ICs (including mixed signal ICs), the majority of which are also differentiated ICs, accounted for approximately 54.2% of our net revenues in the third quarter of 2002 compared to 53.0% in the third quarter of 2001, while discrete devices accounted for approximately 12.3% of our net revenues in the third quarter of 2002 compared to approximately 10.2% in the third quarter of 2001. In recent years, these families of products, in particular analog ICs, have experienced less volatility in sales growth rates and average selling prices than the overall semiconductor industry. However, the difficult competitive environment in the semiconductor market in more recent years has led to price pressures in these product families as well.

In the third quarter of 2002, approximately 28.5% of our net revenues by location of order shipment were realized in Europe, 14.7% in North America, 42.7% in Asia Pacific, 5.1% in Japan and 9.0% in Emerging Markets. North America registered significant declines in revenues of 11.6% in the third quarter of 2002 versus the third quarter of 2001, due to the unfavorable economic environment; Japan, Asia Pacific and Europe revenues increased 26.3%, 25.7% and 13.2%, respectively, and Emerging Markets revenues increased 69.4% in the third quarter of 2002 versus the third quarter of 2001.

During the third quarter of 2002, we had several large customers, with the largest one accounting for 17.8% of our revenues. Our top ten customers accounted for approximately 49.9% of net revenues.

Gross profit. Our gross profit increased by 31.8%, from \$462.1 million in the third quarter of 2001 to \$609.1 million in the third quarter of 2002. As a percentage of net revenues, gross margin increased from 33.0% in the third quarter of 2001 to 37.0% in the third quarter of 2002. This increase was mainly due to the increase in net revenue that resulted in a positive leverage of our manufacturing facilities. Due to the significant increase in volume, the utilization rates of our fabrication plants averaged 82% in the quarter. The impact of changes in foreign exchange rates on gross profit in the third quarter of 2002 compared to the third quarter of 2001 was estimated to be marginally unfavorable since the depreciation of the U.S. dollar versus the euro generated an unfavorable impact on cost of sales which more than offset the favorable impact on net revenues. See *Impact of Changes in Exchange Rates* .

Selling, general and administrative expenses. Selling, general and administrative expenses increased 12.8% from \$144.2 million in the third quarter of 2001 to \$162.7 million in the third quarter of 2002, due primarily to the increase in expenditures associated with the additional activity, partially offset by savings from the cost control programs, hiring freeze and optimization activities that we initiated in early 2001 and continued through the third quarter of 2002. As a percentage of net revenues, selling, general and administrative expenses decreased from 10.3% in the third quarter of 2001 to 9.9% in the third quarter of 2002.

Research and development expenses. Research and development expenses increased 12.6%, from \$229.2 million in the third quarter of 2001 to \$258.0 million in the third quarter of 2002. We continued to invest heavily in research and development during the third quarter of 2002. Strategic research and development spending remains a priority, and we plan to continue our efforts in research and development activities. Our reported research and development expenses do not include marketing design center, process engineering, pre-production or industrialization costs. As a percentage of net revenues, research and development expenses decreased from 16.4% in the third quarter of 2001 to 15.7% in the third quarter of 2002.

Other income and expenses. Other income and expenses include, among other things, funds received through government agencies for research and development expenses, the cost of new plant start-ups, as well as foreign currency gains and losses and the costs of certain activities relating to intellectual property. In the third quarter of 2002, the net effect of these items resulted in income of \$8.0 million compared to expense of \$17.2 million in the third quarter of 2001. This change was primarily due to reduced start-up costs of new 200mm wafer fabrication plants, an increase in funds received through government agencies for research and development expenses, and by the absence of any goodwill amortization in 2002, after implementing FAS 142. In the third quarter of 2001, other income and expenses also included a charge of \$6.1 million goodwill amortization.

Impairment, restructuring and other related closure costs. In the third quarter of 2002, we recorded expenses of \$11.6 million including (i) \$4.7 million relating to decommissioning costs, retention bonuses and contract obligations incurred during the closure of the facilities in Ottawa, Canada, and Rancho Bernardo, California; and (ii) impairment charges for long term investments in SuperH Inc. of \$6.1 million and in Data Play of \$0.8 million. In the third quarter of 2001, we recorded an impairment charge of \$23.3 million relating to the building and facilities of our Rancho Bernardo, California, 150mm fabrication plant; this impairment charge was based on quoted market value and resulted from management's decision to close the plant.

Operating income. Operating income increased 283.4% from \$48.2 million in the third quarter of 2001 to \$184.8 million in the third quarter of 2002, primarily as a result of the significant increase in gross profit. The operating margin in the third quarter of 2002 reached 11.2% compared to 3.4% in the third quarter of 2001. The impact of changes in foreign exchange rates on operating income in the third quarter of 2002 compared to the third quarter of 2001 was estimated to be unfavorable since the depreciation of the U.S. dollar versus the euro generated a negative impact on cost of sales and operating expenses which more than offset the favorable impact on net sales. See *Impact of Changes in Exchange Rates* .

Net interest expense. Net interest expense increased from \$4.8 million in the third quarter of 2001 to \$20.3 million in the third quarter of 2002 as a result of lower interest income on our cash, cash equivalents and marketable securities associated with the sharp decline in U.S. dollar denominated interest rates. Interest expense remained basically flat because the interest rates on our long-term debt were primarily fixed, and therefore were not impacted by the decline in U.S. dollar denominated interest rates.

Equity in loss of joint ventures. During the third quarter of 2002, net loss was \$3.8 million compared to \$1.2 million in the third quarter of 2001. These amounts relate to our investment in SuperH, Inc., the joint venture we formed with Hitachi, Ltd. during the third quarter of 2001, which is still in the start-up phase. During the third quarter of 2002, we wrote off our remaining investment book value of \$3.5 million and also expensed a \$2.6 million capital increase that we are contractually obliged to contribute to SuperH, Inc. in the fourth quarter of 2002. Therefore, we do not expect to record further losses in this joint venture during the fourth quarter of 2002.

Income tax expense. Net income tax expense increased from \$6.2 million in the third quarter of 2001 to \$29.0 million in the third quarter of 2002. The increase in income tax expense was due to the increase in income before income tax and minority interests, since there were no significant variations in the effective tax rate.

Net income. Net income increased from \$35.8 million in the third quarter of 2001 to \$131.2 million in the third quarter of 2002 mainly due to the increase in gross profit. Diluted earnings per share for the third quarter of 2002 were \$0.15, compared to \$0.04 per share for the third quarter of 2001.

First Nine Months of 2002 vs. First Nine Months of 2001

During the first nine months of 2002, according to preliminary estimates, the semiconductor industry experienced a decrease in revenues of approximately 4.9% for the TAM and of approximately 5.1% for the SAM, compared to the first nine months of 2001. Our net revenues in the first nine months of 2002 decreased 7.7% compared to the first nine months of 2001.

Net revenues. Net sales decreased 7.5%, from \$4,865.5 million in the first nine months of 2001 to \$4,499.0 million in the first nine months of 2002. Compared to the first nine months of 2001, the decrease in our net sales in the first nine months of 2002 was primarily due to the decline in our selling prices, which more than offset the strong increase in the volume of sales. Other revenues, consisting primarily of co-development contract fees, certain contract indemnity payments and patent royalty income, decreased from \$43.5 million in the first nine months of 2001 to \$32.5 million in the first nine months of 2002. This decrease was primarily due to a decrease in revenues from co-development contract services. Net revenues declined 7.7%, from \$4,909.0 million in the first nine months of 2001 to \$4,531.5 million in the first nine months of 2002.

The Telecom, Peripheral and Automotive Group's net revenues decreased 5.0% compared to the first nine months of 2001 primarily as a result of volume decreases in sales of wireless, digital and analog, and wireline products and price decreases of printer products that were partially offset by increase in sales of automotive-audio and data storage products. The Discrete and Standard ICs Group's net revenues increased 6.1% due to increased sales of transistor and standard commodities products partially offset by price decreases of discrete products. The Memory Products Group's net revenues decreased 33.2% as a result of significant volume decreases in sales of EPROM and smart card products, and a decrease in prices of flash memory products. The Consumer and Microcontrollers Group's net revenues increased 10.6% mainly due to significant volume increases in sales of DVD, display and TV, and microcontrollers products that were partially offset by a decrease in sales of digital consumer and imaging products; during 2002 we have also terminated our graphic products line.

During the first nine months of 2002, we maintained our focus on differentiated ICs, which accounted for 69.6% of our net revenues, compared to 64.9% in the first nine months of 2001. Such products foster close relationships with customers, resulting in early knowledge of their evolving requirements and opportunities to access their markets for other products. Analog ICs (including mixed signal ICs), the majority of which are also differentiated ICs, accounted for approximately 52.9% of our net revenues in the first nine months of 2002 compared to 50.7% in the first nine months of 2001, while discrete devices accounted for approximately 12.0% of our net revenues in the first nine months of 2002 compared to approximately 10.4% in the first nine months of 2001. In recent years, these families of products, in particular analog ICs, have experienced less volatility in sales growth rates and average selling prices than the overall semiconductor industry. However, the difficult competitive environment in the semiconductor market in more recent years has led to price pressures in these product families as well.

In the first nine months of 2002, approximately 28.9% of our net revenues by location of order shipment were realized in Europe, 14.8% in North America, 43.5% in Asia Pacific, 4.3% in Japan and 8.5% in Emerging Markets. Japan, North America and Europe registered declines in revenues of 31.9%, 26.0% and 24.1%, respectively, in the first nine months of 2002 versus the first nine months of 2001, due to the unfavorable global economic environment; Asia Pacific revenues increased 14.8%, and Emerging Markets revenues increased 40.6% in the first nine months of 2002 versus the first nine months of 2001 in part due to the move of some customers' production facilities to low labor cost areas.

During the first nine months of 2002, we had several large customers, with the largest one accounting for 16.5% of our revenues. Our top ten customers accounted for approximately 50.3% of net revenues.

Gross profit. Our gross profit decreased by 11.5%, from \$1,850.4 million in the first nine months of 2001 to \$1,636.9 million in the first nine months of 2002. As a percentage of net revenues, gross margin decreased from 37.7% in the first nine months of 2001 to 36.1% in the first nine months of 2002. This was mainly due to the negative impact produced by strong pressures on our selling prices. Gross profit, for the first nine months of 2001, was also negatively impacted by an extraordinary charge of \$70.7 million related to inventory write-off originated by significant cancellations in our backlog. The impact of changes in foreign exchange rates on gross profit in the first nine months of 2002 compared to the first nine months of 2001 was estimated to be slightly unfavorable since the depreciation of the U.S. dollar versus the euro generated an unfavorable impact on cost of sales which more than offset the positive impact on net revenues. See [Impact of Changes in Exchange Rates](#) .

Selling, general and administrative expenses. Selling, general and administrative expenses decreased 7.4% from \$501.1 million in the first nine months of 2001 to \$464.1 million in the first nine months of 2002, due primarily to savings resulting from the cost control programs, hiring freeze and optimization activities that we initiated early 2001 and also continued during the first nine months of 2002. As a percentage of net revenues, selling, general and administrative expenses remained stable at 10.2% in the first nine months of 2001 and 2002.

Research and development expenses. Research and development expenses decreased 2.3%, from \$757.0 million in the first nine months of 2001 to \$739.9 million in the first nine months of 2002. This decrease resulted primarily from the implementation of our cost control programs and declining expenses in non-core research and development expenditures. As a consequence of the acquisition of Alcatel Microelectronics, we recorded a charge of \$7.6 million in the first nine months of 2002 for in-process research and development. We continued to invest heavily in research and development during the first nine months of 2002. Strategic research and development spending remains a priority and we plan to continue our efforts in research and development activities. Our reported research and development expenses do not include marketing design center, process engineering, pre-production or industrialization costs. As a percentage of net revenues, research and development expenses increased from 15.4% in the first nine months of 2001 to 16.3% in the first nine months of 2002.

Other income and expenses. Other income and expenses include, among other things, funds received through government agencies for research and development expenses, the cost of new plant start-ups, as well as foreign currency gains and losses and the costs of certain activities relating to intellectual property. In the first nine months of 2002, the net effect of these items resulted in expense of \$11.4 million compared to income of \$10.9 million in the first nine months of 2001. This increase in expenses was primarily due to decreased income from the sale of investments and costs of moving equipment from our facility of Rancho Bernado, California, to other facilities, partially offset by an increase in funds received through government agencies for research and development expenses and decreased start-up costs of new 200mm wafer fabrication. In 2002, goodwill was no longer amortized, as a consequence of implementation of FAS 142. In the first nine months of 2001, other income and expenses included \$20.5 million goodwill amortization.

Impairment, restructuring and other related closure costs. In the first nine months of 2002, we recorded expenses \$29.6 million including (i) \$22.0 million relating to decommissioning costs, retention bonuses and contract obligations incurred during the closure of the facilities in Ottawa, Canada, and Rancho Bernardo, California; (ii) impairment charges for long term investments in SuperH Inc. of \$6.1 million and in Data Play of \$0.8 million and (iii) \$0.7 million restructuring expenses for the Graphics division of the Consumer and Microcontrollers Group. In the first nine months of 2001, we had recorded impairment charges of \$319.6 million; additionally we had recorded restructuring and other related closure costs of \$15.0 million relating to the closure of our facility in Ottawa, Canada.

Operating income. Operating income increased from \$268.6 million in the first nine months of 2001 to \$391.9 million in the first nine months of 2002, primarily as a result of the significant decrease in our impairment charges, restructuring and other related closure costs that was greater than our decrease in gross profit during the first nine months of 2002. The impact of changes in foreign exchange rates on operating income in the first nine months of 2002 compared to the first nine months of 2001 was estimated to be unfavorable since the depreciation of the U.S. dollar versus the euro generated an unfavorable impact on cost of sales and operating expenses which more than offset the positive impact on net sales. See *Impact of Changes in Exchange Rates*.

Net interest expense. Net interest expense increased from \$1.3 million in the first nine months of 2001 to \$51.5 million in the first nine months of 2002 as a result of lower interest income on our cash, cash equivalents and market securities associated with the sharp decline in U.S. dollar denominated interest rates. Interest expense remained basically flat because the interest rates on our long-term debt are primarily fixed, and therefore were not impacted by the decline in U.S. dollar denominated interest rates.

Equity in loss of joint ventures. During the first nine months of 2002, net loss was \$11.0 million compared to \$1.2 million in the first nine months of 2001. These amounts include our investment in SuperH, Inc., the joint venture we formed with Hitachi, Ltd. during the third quarter of 2001, which is still in the start-up phase. During the third quarter of 2002, we wrote off our remaining investment book value of \$3.5 million and also expensed a \$2.6 million capital increase that we are contractually obliged to contribute to SuperH, Inc. in the fourth quarter of 2002. Therefore, we do not expect to record further losses in this joint venture during the fourth quarter of 2002.

Income tax expense. Income tax expense was \$51.8 million in the first nine months of 2001 and \$57.9 million in the first nine months of 2002. The increase in income tax expense was due to the increase in income before income tax and minority interests. No major variation was accounted in the effective tax rate.

Net income. Net income for the first nine months of 2002 was \$268.8 million compared to \$212.1 million for the first nine months of 2001, which included significantly higher costs of restructuring. Diluted earnings per share for the first nine months of 2002 were \$0.30, compared to \$0.23 per share for the first nine months of 2001.

Impact of Changes in Exchange Rates

Our results of operations and financial condition can be significantly affected by changes in exchange rates between the U.S. dollar and other currencies, particularly the euro, the Japanese yen and other Asian currencies.

Revenues for certain products (primarily dedicated products sold in Europe and Japan) that are quoted in currencies other than the U.S. dollar are directly affected by fluctuations in the value of the U.S. dollar. Revenues for all other products, which are quoted in U.S. dollars and translated into local currencies for payment, tend not to be affected significantly by fluctuations in exchange rates except to the extent that there is a lag between changes in currency rates and adjustments in the local currency equivalent price paid for such products.

Certain significant costs incurred by us, such as manufacturing labor costs and depreciation charges, selling, general and administrative expenses, and research and development expenses, are incurred in the currencies of jurisdictions where our operations are located. Significant fluctuations in the value of these currencies, particularly the euro, compared to the U.S. dollar can affect our costs and therefore our profitability.

Our principal strategies to reduce the risks associated with exchange rate fluctuations have been (i) to increase the proportion of sales to customers denominated in U.S. dollars, (ii) to purchase raw materials and services in transactions denominated in U.S. dollars (thereby reducing the exchange rate risk for costs relative to revenues, which are principally denominated or determined by reference to the U.S. dollar), and (iii) to manage certain other costs, such as financial costs, to maintain an appropriate balance between U.S. dollars and other currencies based upon the currency environment at the time. From time to time, we purchase or sell forward foreign currency exchange contracts and currency options to cover currency risk in payables or receivables. We have not experienced significant gains or losses as a result of exchange coverage activities. Our management strategies to reduce exchange rate risks have served to mitigate, but not eliminate, the positive or negative impact of exchange rate fluctuations. Furthermore, the introduction of the euro as of January 1, 1999, has served to reduce the number of currencies whose exchange rate fluctuations versus the U.S. dollar may impact our results, thus making our exposure to exchange rate fluctuations more concentrated.

Assets and liabilities of subsidiaries are, for consolidation purposes, translated into U.S. dollars at the period-end exchange rate. Income and expenses are translated at the average exchange rate for the period. Adjustments resulting from the translation are recorded directly in shareholders' equity, and are shown as accumulated other comprehensive loss in the consolidated statements of changes in shareholders' equity. The balance sheet impact of such translation adjustments has been, and may be expected to be, significant from period to period. At September 28, 2002, our outstanding indebtedness was denominated principally in U.S. dollars, euro, and Singapore dollars.

Liquidity and Capital Resources

Treasury activities are regulated by our procedures, which define policies, objectives and controls. The policies focus on the management of our financial risk in terms of exposure to currency rates and interest rates. Our objectives are to neutralize our exposure to changes in exchange rates, to optimize the use of credit facilities and funds available, and to obtain the best possible market conditions for our financial and treasury operations. Our treasury controls include systematic reporting to senior management and are subject to internal audits. Most of our treasury activities are centralized, with any local treasury activities subject to oversight from our head treasury office. Nearly all of our cash and cash equivalents are held in U.S. dollars and are placed with financial institutions rated A+ or higher. Marginal amounts are held in other currencies. Foreign currency operations and hedging transactions are performed only to cover commercial positions.

At September 28, 2002, cash and cash equivalents totaled \$1,066.6 million, compared to \$2,438.8 million at December 31, 2001, and marketable securities totaled \$1,202.2 million compared to \$5.4 million at December 31, 2001. Included in marketable securities are \$1.2 billion of Credit Linked Notes/Deposits, which represent bank deposits having as underlying assets bonds issued by different banks with a minimum rating of A. Interest on these deposits is paid quarterly and the interest rate is fixed every three months based on the LIBOR rate of the U.S. dollar plus a spread. The final maturity of these deposits is December 30, 2002, date on which the principal will be repaid to the Company. At any time during the period, the Company can ask for the early repayment of these deposits.

Cash from operating activities. The major source of cash during the first nine months of 2002 and in prior periods was cash provided by operating activities. Our net cash generated from operating activities totaled \$1,154.0 million in the first nine months of 2002 compared to \$1,516.9 million in the first nine months of 2001. This decrease was partly attributable to the 6.0% decrease in our net income, adjusted for non-cash items, of \$1,405.0 million in the first nine months of 2002, from \$1,494.2 million in the first nine months of 2001.

Changes in our assets and liabilities resulted in \$251.0 million of net cash used in the first nine months of 2002, compared to \$22.6 million of net cash provided in the first nine months of 2001, mainly due to the increased cash required by the higher level of sales in the third quarter of 2002. In the first nine months of 2002, the increase in our trade accounts receivable used net cash of \$74.3 million; the increase in our inventory used net cash of \$64.9 million; the decrease in our trade accounts payable used net cash of \$44.7 million, while the net variation in our other asset and liabilities used \$67.1 million in cash. At September 28, 2002, we had sold without recourse to financial institutions \$124.4 million of receivables that fall due in the fourth quarter of 2002.

Cash used in investing activities. Net cash used in investing activities was \$2,312.4 million in the first nine months of 2002 compared to \$2,709.2 million in the first nine months of 2001. The purchase of marketable securities, as short-term investment, was the major use of cash in investing activities and accounted for \$1,200.0 million in the first nine months of 2002 and for \$1,100.5 million in the first nine months of 2001. Payment for purchases of tangible assets decreased significantly to \$770.7 million in the first nine months of 2002, from \$1,563.1 million in the first nine months of 2001. Net cash generated from operating activities in both the first nine months of 2001 and 2002 was the main source of funds to finance capital expenditures.

On June 26, 2002, we completed the acquisition of Alcatel Microelectronics; concurrently we sold to AMI Semiconductors, Inc. the just acquired mixed signal business activities of Alcatel Microelectronics and also its fabrication facility. In the first nine months of 2002, the payment for the purchase of Alcatel Microelectronics net of \$68.0 million cash received was \$308.8 million. In the first nine months of 2002, net investment in intangible and financial assets was \$34.3 million compared with \$109.3 million in the first nine months of 2001.

Operating cash flow. The operating cash flow (defined as net cash from operating activities minus cash used in the purchase of tangible assets and minus cash used in investments in intangible and financial assets) was positive at \$40.2 million; however, excluding the acquisition of Alcatel Microelectronics, it was positive at \$349.0 million in the first nine months of 2002 compared to a negative amount of \$155.5 million in the first nine months of 2001.

Cash from financing activities. Net cash used by financing activities was \$223.1 million in the first nine months of 2002 compared to \$121.2 million net cash provided in the first nine months of 2001.

During the first nine months of 2002, cash used for the repayment of long-term debt, net of proceeds from issuance of long-term debt, was \$66.6 million. During the first nine months of 2002, we repurchased shares of our common stock for \$115.0 million; the repurchased shares were designated to fund our most recent employee stock option plan. We paid a cash dividend of \$0.04 per share on April 22, 2002 for a total amount of \$35.6 million.

Net financial position. We had a negative net financial position (cash, cash equivalents and marketable securities net of total financial debt) of \$669.2 million at September 28, 2002, compared to a negative net financial position of \$456.6 million at December 31, 2001. At September 28, 2002, the aggregate amount of our long-term debt was approximately \$2,922.7 million, of which \$775.4 million consisted of zero-coupon convertible Liquid Yield Option Notes (LYONs) due 2009 and \$1,586.6 million of convertible bonds due 2010; additionally the aggregate amount of our short-term credit facilities was approximately \$1,049 million, under which approximately \$15.3 million of indebtedness was outstanding.

As of the end of the first nine months of 2002, we currently have the following credit ratings on our outstanding convertible debt:

	Moody's Investors Services	Standard & Poor's
LYONs due 2009	Baa1	BBB+
Convertible bonds due 2010	A3	A-

In the event of a downgrade of these ratings, we believe we would continue to have access to sufficient capital resources.

Commitments and contingencies. Our commitments as at September 28, 2002, were as follows:

Payments due by period

	Total	2002	2003	2004	2005	2006	Thereafter
(in millions of U.S. dollars)							
Operating leases ⁽¹⁾	157.5	6.2	22.0	19.0	16.2	15.2	78.9
Capital leases ⁽²⁾	31.8	1.9	3.7	3.7	3.7	3.7	15.1
Purchase commitments ⁽³⁾	726.8	356.3	271.3	78.5	20.7		
Contingent obligations ⁽⁴⁾	58.5		47.4	7.4	3.7		
	974.6	364.4	344.4	108.6	44.3	18.9	94.0

(1) Operating leases are mainly related to building leases.

(2) Capital lease for the building of Crolles 2

(3) Purchase obligations include primarily commitments for the purchase of equipment, purchase contracts for outsourced foundry wafers and for the purchase of software licenses.

(4) Contingent obligations related to additional contractual amounts which could be paid for the cooperation agreement with Philips Semiconductors International BV and Motorola, Inc. at Crolles 2, for the joint venture with Hitachi, Ltd., and for the agreements signed with Tioga Technologies Ltd. and Dai Nippon Printing.

Financial outlook. We currently expect that capital spending for 2002 will be approximately \$1.0 billion, reduced from our previous estimate of \$1.2, although we have the ability to adjust that amount up or down in response to the changes in market conditions. As of September 28, 2002, we had \$411 million in outstanding commitments for purchases of equipment. The most significant of our 2002 capital expenditure projects are expected to be (i) the upgrading of the 200mm front-end plant in Agrate (Italy) for the development of the new generation of technologies below 0.13 micron; (ii) the first stage of infrastructure construction of the 300mm front-end plant located in Crolles (France); (iii) the increase in capacity in our 200mm front-end plants in Rousset (France) and in Singapore; and (iv) the construction of the building for the new 300mm front-end plant in Catania (Italy). The new 300mm wafer research fabrication and pilot line at Crolles using 0.13 micron and below process technology is being constructed and will operate in partnership with Philips Semiconductors, Motorola and Taiwan Semiconductor Manufacturing Company (TSMC). We will continue to monitor our level of capital spending, however, taking into consideration factors such as trends in the semiconductor market, capacity utilization and announced additions. Since the pace of the economic and industry recovery is still uncertain, we are led to adopt a cautious approach to 2003 and, at the date of this report, we expect our 2003 capital expenditure to be at levels similar to 2002 levels.

We expect to have significant capital requirements in the coming years and intend to continue to devote a substantial portion of our net revenues to research and development. We plan to fund our capital requirements from cash from operations, available funds and available support from third parties (including state support), and may borrow under our available credit lines and, to the extent necessary or attractive based on market conditions prevailing at the time, the sale of debt or additional equity securities. A substantial deterioration of our economic results and consequently of our profitability could generate a deterioration of the cash generated by our operating activities. Therefore, there can be no assurance that, in future periods, we will generate the same level of cash as in the previous years to fund our capital expenditures for expansion plans, our working capital requirements, research and development and industrialization costs. In addition, there can be no assurance that additional financing will be available as necessary, or that any such financing, if available, will be on terms acceptable to us. We believe that our available funds, available support from third parties, and additional borrowings will be sufficient to meet our anticipated needs for liquidity through at least 2003.

Impact of Recently Issued U.S. Accounting Standards

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, *Business Combinations* (FAS 141), which is applicable for all business combinations initiated after June 30, 2001. This statement eliminates the use of the pooling-of-interests method and provides specific criteria for the recognition of intangible assets apart from goodwill. In the second half of 2001, we did not enter into any combination, which would require the application of FAS 141. In the first quarter of 2002, we concluded an asset sale and purchase agreement with Alcatel Business Systems to acquire certain assets dedicated to custom ASICs activities in the mobile phone market; the agreement also included the transfer from Alcatel Business Systems to us of a dedicated development team. The purchase price was approximately \$1 million and we recorded the value of the workforce transferred as goodwill. On June 26, 2002, we completed the acquisition of Alcatel Microelectronics, a company of Alcatel group, which manufactures and markets semiconductor integrated circuits. Concurrently we sold to AMI Semiconductors, Inc. the just acquired mixed signal business activities of Alcatel Microelectronics and also its fabrication facility. In the first nine months of 2002, the consideration for the purchase of Alcatel Microelectronics net of the proceeds from the resale to AMI was \$308.8 million. The purchase price allocation is based on a third party independent appraisal and makes reference to the future business assumptions made by management, based on management's best knowledge of the acquired company and the industry. Such assumptions might be revisited as management acquires further knowledge of the acquired company or industry conditions change. Purchase price allocation may therefore be changed slightly in the next nine months. We recorded as intangible assets \$110.5 million for core technologies, \$57.7 million as an intangible asset for the supply contract signed with Alcatel group and \$104.0 million as goodwill. In addition, we consolidated the fair value of assets and liabilities of entities acquired from Alcatel Microelectronics. As a result of this purchase price allocation, we also recorded a charge of \$7.6 million in the second quarter of 2002 for in-process research and development.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangibles Assets* (FAS 142), which is effective for fiscal years beginning after December 15, 2001. FAS 142 primarily addresses the accounting that must be applied to goodwill and intangible assets subsequent to their initial recognition. In particular, the statement requires that goodwill and indefinite lived intangible assets be no longer amortized but be subject to annual impairment tests to determine the appropriate carrying value. FAS 142 also requires the reclassification of any intangible assets which do not meet the FAS 141 criteria for recognition separately from goodwill. We adopted the standards required by this statement in the first quarter of 2002. In connection with the adoption of FAS 142, we reclassified \$2.8 million of our intangible assets to goodwill, which had a total carrying value after this reclassification of \$65.8 million at January 1, 2002. In the first quarter of 2002, we performed the transitional impairment review required by FAS 142 and determined that no adjustment for impairment loss was required as a result of adopting the standard. For our existing goodwill and the reclassified intangible assets, we will no longer record amortization, as would have been required prior to the adoption of FAS 142. Had FAS 142 not been adopted, and excluding any impact of businesses acquired during 2002, we would have recorded an additional amortization expense of \$12.7 million during the first nine months of 2002.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), which is effective for fiscal years beginning after December 15, 2001.

Long-Lived Assets to be held and used. FAS 144 retains the requirements of Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* (FAS 121) to (i) recognize an impairment loss only if the carrying amount of a long-lived assets is not recoverable from its undiscounted cash flows and (ii) measure an impairment loss as the difference between the carrying amount and fair value of the asset. To resolve implementation issues, FAS144 removes goodwill from its scope and therefore, eliminates the requirement of FAS 121 to allocate goodwill to long-lived assets to be tested for impairment.

Long-Lived Assets to be disposed of other than by sale. FAS 144 requires that a long-lived assets to be abandoned, exchanged or distributed in a spin-off be considered held and used until it is disposed of. FAS 144 requires the depreciable life of a long-lived asset to be abandoned be revised and also requires that an impairment loss be recognized at the date a long-lived asset is exchanged or distributed in a spin-off if the carrying amount of the assets exceeds its fair value.

Long-Lived assets to be disposed of by sale. The accounting model retains the requirements of FAS 121 to measure long-lived asset classified as held for sale at the lower of its carrying amount or fair value less cost to sell and to cease depreciation (amortization). Therefore, discontinued operations are no longer measured on a net realizable value basis, and future operating losses are no longer recognized before they occur.

We adopted FAS 144 during the first quarter of 2002 and determined that no adjustment was required as a result of adopting the standard.

In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (FAS 146), which is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. This statement nullifies Emerging Issues Task Force (EITF) Issue No. 94-3 *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* (Issue 94-3). FAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a disposal activity covered by FAS No. 144. Those costs include, but are not limited to, the following:

- One-time termination benefits provided to current employees,
- Costs to terminate a contract that is not a capital lease, and
- Costs to consolidate facilities or relocate employees.

The principal difference between FAS 146 and Issue 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or a disposal activity. FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, a liability being defined as probable future sacrifice arising from present obligations. Under Issue 94-3, a liability for an exit cost as defined in Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. Under FAS 146, an entity's commitment to a plan, by itself, does not create a permanent obligation to others that meets the definition of a liability.

We early adopted FAS 146 during the third quarter of 2002, entering a provision of \$0.9 million for severance costs associated with termination of activities in the United States. Had this statement not been adopted during the third quarter of 2002, as previously required by Issue 94-3 we would have recorded additional \$0.7 million expenses relating to severance benefits to be paid to employees whose transition period exceeds 60 days. These additional expenses will be booked over the whole transition period.

Euro Conversion

On January 1, 1999, eleven of the fifteen member countries of the European Union established fixed conversion rates between their existing national currencies and the euro. The participating countries agreed to adopt the euro as their common legal currency on that date. Until January 1, 2002, either the euro or a participating country's present currency (a national currency) was accepted as legal currency. On January 1, 2002, euro-denominated bills and coins were issued and national currencies were withdrawn from circulation shortly thereafter.

We do not believe that the introduction and use of the euro has materially affected our foreign exchange activities, or our use of derivatives and other financial instruments, or has resulted in any material increase in costs to us.

During October 2001, we successfully switched the accounts of our legal entities operating in the Euro zone from accounts denominated in national currencies to accounts denominated in euro.

Backlog

Our backlog has decreased significantly since the end of 2000 through 2001, due to the highly negative downturn in the semiconductor industry, which also resulted in an unprecedented high level of order cancellations. Because of the large reduction in our customer demand and backlog, during 2001 most of our manufacturing facilities operated below capacity. Additionally, we temporarily closed some lines during the year, mainly at our most mature plants. We also reduced the use of external front-end and back-end manufacturing services. During the first nine months of 2002, net order flow accelerated and our backlog increased compared to the end of 2001, although it has not reached the levels registered in 2000.

During the first nine months of 2002, we had several large customers, with the Nokia group of companies being the largest and accounting for 16.5% of our revenues. Our top ten customers accounted for approximately 50.3% of net revenues. We cannot guarantee that such customers, or any other customer, will continue to generate revenues for us at the same levels.

If we were to lose one or more of our key customers, or if they were to significantly reduce their bookings, or fail to meet their payment obligations, our operating results and financial condition could be adversely affected.

Forward Looking Statements

Some of the statements contained in the Overview-Business Outlook and in the Liquidity and Capital Resources-Financial Outlook sections are forward looking statements that involve a number of risks and uncertainties. Our operating results are also affected by a wide variety of other factors that could materially and adversely affect revenues and profitability or lead to significant variability of operating results, including, among others, capital requirements and the availability of funding, competition, new product development and technological change and manufacturing. In addition, a number of other factors could lead to fluctuations in operating results, including order cancellations or reduced bookings by key customers or distributors, intellectual property developments, international events, currency fluctuations, problems in obtaining adequate raw materials on a timely basis, and the loss of key personnel. As only a portion of our expenses varies with our revenues, there can be no assurance that we will be able to reduce costs promptly or adequately in relation to revenue declines to compensate for the effect of any such factors. As a result, unfavorable changes in the above or other factors have in the past and may in the future adversely affect our operating results. Operating results have also been and may be expected to continue to be substantially affected by the cyclical nature of the semiconductor and electronic systems industries, the speed of some process and manufacturing technology developments, market demand for existing products, the timing and success of new product introductions and the levels of provisions and other unusual charges incurred. Unfavorable changes in the above or other factors listed under Cautionary Statement Regarding Forward-Looking Statements and Item 2. Key Information-Risk Factors from time to time in our SEC filings, including in our Annual Report on Form 20-F filed on May 24, 2002, could have a material adverse effect on our business or financial condition.

