

Dialog Semiconductor  
Annual Report 1999



Intelligence designed  
to perfection

## Dialog Semiconductor Plc – Selected Financial Data

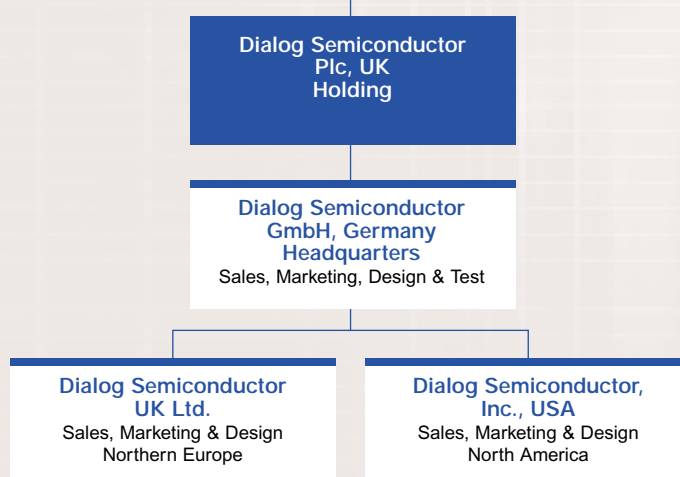
(in thousands of €)	1999	1998 <sup>1)</sup>	1997
Revenues	87,246	44,478	38,528
EBITDA	15,351	7,855	3,451
EBIT (operating profit)	11,566	5,311	2,284
Net income	6,680	2,372	1,023
Cash flow from operations	(907)	7,124	1,249
Redeemable preference shares	–	17,120	–
Shareholders' equity	68,611	3,036	4,408
Total assets	90,864	31,920	16,225
Capital expenditures	14,487	3,273	1,393
Research and development	11,108	6,656	3,773
Basic earnings per share <sup>2)</sup>	0.31	0.08	0.06
Employees (at December 31)	142	105	91

<sup>1)</sup> 1998 information is presented on a pro forma basis (unaudited) excluding the acquired in-process technology charge of € 9.3 million.

<sup>2)</sup> Earnings per share information for the fiscal years ended December 31, 1998 and 1997 are on a pro forma basis assuming that the weighted average shares outstanding for the period from March 1, 1998 to December 31, 1998 were also outstanding for those periods.

## Overview of the Group Structure

Apax Partners <b>43 %</b>	Adtran <b>12.6 %</b>	Ericsson <b>5.6 %</b>	Management <b>8.2 %</b>	Free Float <b>30.6 %</b>
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# Glossary

## Analog

A type of signal in an electronic circuit that takes on a continuous range of values rather than only a few discrete values.

## Analog circuits

Circuits that process analog signals.

## ASIC

Application Specific Integrated Circuit; an integrated chip which is individually custom designed for a specific application rather than a general-purpose standard chip such as a microprocessor or memory chip.

## Asynchronous mode

A standard for data transmission where each data package has a start and stop bit.

## Audio CODEC

The critical interface between outside world analog signals (such as the human voice) and the digital data processing inside a mobile phone. It acts as the main contributor to the voice quality of a mobile phone. It converts the digital signal received from the baseband subsystem into an analog signal that is fed to the loudspeaker and also converts the analog signal from the microphone into a digital signal.

## Audio CODEC ASICs

ASICs designed to perform the Audio CODEC function.

## Back-end assembly

The second phase of chip manufacturing during which the die is assembled into packaging designed not only to protect it, but also to provide external connections via a series of very fine wires.

## Baseband

The frequency band occupied by the aggregate of all the voice and data signals used to modulate a radio carrier.

## Baseband processing subsystem

The manner in which a micro-controller and a DSP control a baseband processor and interact with the operator of a mobile phone through the phone's display and keypad.

## Bipolar

The traditional methodology used to develop transistors.

## Bluetooth

A radio technology designed to standardize the transmission of signals over short distances between telephone, computers and other devices without the use of wires.

## Broadband

Refers to a communications network in which frequency range is divided into multiple independent channels for simultaneous transmission of signals such as voice, data or video.

## Ceramic transducers

A ceramic device that converts energy from one form to another by taking physical phenomena such as pressure or temperature, and converting them into an electronic signal and vice versa, e.g. as a loudspeaker.

## Chips

Electronic integrated circuits which are typically made of silicon.

## CODEC

A coding/decoding device that converts, or encodes, analog signals into a form for transmission on a digital circuit. The digital signal is then decoded back to analog signals at the receiving end of the transmission link. CODECs allow voice and video transmission over digital links and may also support signal compression.

## Digital

A type of signal used to transmit information that has only discrete levels of some parameter (usually voltage).

## Foundry

A manufacturing plant where wafers are produced.

## GSM

Global System for Mobile Communications; GSM has become the world's most widely used mobile system, operating on the 900 MHz and 1800 MHz frequencies in Europe, Asia and Australia, and the 1900 MHz frequency in North America and Latin America.

## IC

Integrated Circuit; an electronic device which contains numerous components on a single chip.

## ISDN

Integrated Services Digital Network.

#### Mixed signal

Describes a combination of analog and digital signals being generated, controlled or modified on the same chip.

#### Noise-shaping

The process of moving baseband noise to higher frequencies to process the baseband signal without background noise.

#### Overvoltage clamp

A device to restrict input voltages to acceptable limits.

#### Power management subsystem

Responsible for overall power consumption and supply of other subsystems in mobile phones, primarily affecting the total talk and standby times of a mobile phone.

#### Silicon

A semi-metallic element used to create a wafer. It is the most common semiconductor material, used in about 95% of all manufactured chips.

#### UMTS

Universal Mobile Telecommunications System; the name for the "third generation" mobile telephone standard in Europe, standardized by ETSI (European Telecommunications Standardization Institute).

#### Wafer

A slice of silicon sliced from a 4, 5, 6 or 8 inch diameter silicon bar which is used as the foundation on which to build semiconductor products.

#### WAP

Wireless application protocol.

## Important Dates

#### May 18, 2000

Annual shareholders' meeting in London

#### July 26, 2000

Release of half year results

#### October 25, 2000

Release of third quarter results

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# Management Board

## Roland Pudelko

President and CEO (47)

Joined Dialog Semiconductor in 1989 as a managing director. He has 22 years of experience in electronics and microelectronics, primarily in management positions within the Daimler-Benz Group. During that time, he was a board member of a joint venture with the Taiwanese company ACER and in the TEMIC Group he was responsible for the coordination of world-wide design and engineering. Mr. Pudelko has a diploma in communication technologies from the vocational college (Fachhochschule) of Esslingen. He is also the sole managing director of Dialog Semiconductor GmbH and the other consolidated subsidiaries of Dialog Semiconductor Plc. He is a member of the board of directors of ESM Holdings Limited, in which the Company holds a minority interest.

## Gary Duncan

Vice-President, Operations (44)

Joined Dialog Semiconductor in October 1987. He obtained a Higher National Certificate in electronics and mathematics in 1978 from Plymouth Polytechnic. He is also a Technical Engineer of the Chartered Engineering Institute.

## Jeff Garris

Vice-President, Sales (45)

Joined Dialog Semiconductor in April 1998. He has more than 25 years of experience in sales and marketing in the electronic component industry and most recently held a sales management position with international responsibility for the TEMIC Semiconductor Group of DaimlerChrysler. He studied mathematics at the University of South Carolina, USA.

## Peter Hall

Vice-President, IT and Quality (48)

Joined Dialog Semiconductor in July 1987. He obtained his BSc (Honors) in electrical and electronic engineering in 1974 from the University of Newcastle upon Tyne and his MSc in digital techniques in 1977 from the University of Edinburgh. Before joining Dialog Semiconductor he held various management and engineering positions at STC Semiconductors and MEM in Switzerland.

## Martin Klöble

Vice-President, Finance and Controlling (40)

Joined Dialog Semiconductor on July 1, 1999. He holds an MBA from the University of Stuttgart-Hohenheim and is qualified as a tax consultant (Steuerberater) as well as a certified public accountant in Germany (Wirtschaftsprüfer) and in the United States (CPA). Before joining Dialog Semiconductor he worked with KPMG, since the beginning of 1999 as a partner.

## Richard Schmitz

Vice-President, Engineering (43)

Joined Dialog Semiconductor in 1989. He received a diploma in engineering for communications electronics in 1983 from vocational college (Fachhochschule) in Trier. Prior to joining Dialog Semiconductor, he held various design-related positions at Hewlett Packard's instruments division in Böblingen and the Institute for Microelectronics, Stuttgart.



# Letter to our Shareholders



Dear Shareholders,

1999 was the most successful year in the history of Dialog Semiconductor Plc. Revenues almost doubled when compared to 1998 (+ 96%), reaching a new high of € 87.2 million. Earnings before interest and taxes (EBIT) increased by 118% to € 11.6 million. Net income was up by more than 182% (excluding the acquired technology charge incurred in 1998) over the prior year at € 6.7 million.

We were able to show constant growth during all of 1999. This growth was primarily driven by the wireless communications market. The number of users and the number of mobile telephones sold increased more rapidly than anticipated in 1999, reaching record heights. In the fourth quarter, Dialog Semiconductor was also able to benefit from the very high demand for mobile telephones during the Christmas shopping season. Our revenues rose by 134% in the fourth quarter 1999 compared to the same quarter in 1998.

The success of our business reconfirms our strategy. We have developed a successful business model whereby we concentrate on the development of application specific semiconductors for the rapidly growing wireless communications market and for selected areas of the automotive electronics industry. Our outsourcing policy is also a distinct advantage. We subcontract the capital intensive manufacture and assembly of our semiconductors. We do, however, retain full responsibility over the entire production process and run our own quality control tests designed to guarantee the performance of our products before delivery to our customers. Our approach has been successful in establishing close ties with leading manufacturers in the wireless communications industry. These companies respect our competence in Mixed Signal ASIC design, the quality of our products and our better than average time to market.

The most important and successful event in 1999 was our listing as a public company. Since October 13, 1999 Dialog Semiconductor has been listed on the Neuer Markt (Frankfurt) and on the EASDAQ (Brussels). Our offering to the public included 3.75 million shares from the Company as well as 1.85 million shares from existing shareholders. The issue price was € 19. Our shares closed at € 73.50 on December 30, 1999 and our company was one of the most successful entries on the Neuer Markt in terms of share price development.

I would like to take the opportunity in this, our first annual report as a listed company, to thank everyone who has been instrumental in our success. My thanks go to our shareholders, our customers and partners, and to all our employees in Germany, the UK and the USA. I assure you that we will continue to pursue our business aims so that the current year could be as successful as 1999. Our company goal for 2000 is simple: continued growth.

Kirchheim/Nabern, March 2000

A handwritten signature in blue ink, which appears to read 'R. Pudelko'.

Roland Pudelko  
CEO & President





## Positive market environment continues.

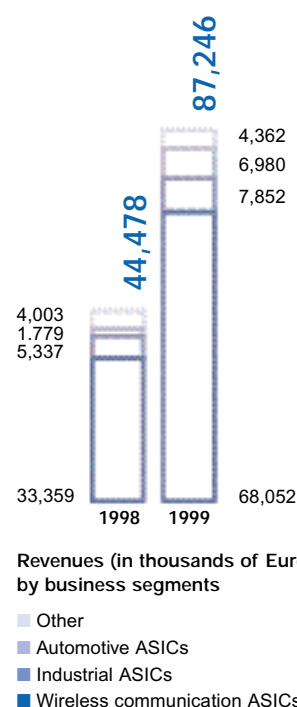
Growth in the wireless communications industry and in the related demand for semiconductors continued at record levels throughout 1999. Market drivers were the demand of new subscribers as well as the increased demand for replacement telephones. According to the latest available information from Dataquest, the number of subscribers grew to 426 million worldwide in 1999. This translates into an increase of 38% over 1998. Dataquest forecasts a compound annual growth rate in excess of 19% until 2003.

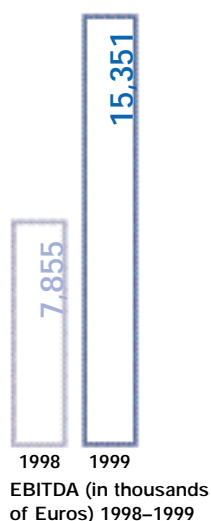
1999 was a year not only of rapid growth in the wireless communications industry, but was also marked by the continued development and market introduction of new technologies and applications. The most important of these new technologies is the WAP standard for wireless Internet access, the equipment manufacturers' agreement relating to the introduction of the "third generation" of wireless communications systems (most importantly the new worldwide UMTS Standard), and the continued development of the "Bluetooth" standard which will allow wireless transmission of signals between telephone, computer and other hardware.

Demand for semiconductors in the automotive electronics industry increased too. Contributing factors were the development of new safety and comfort elements as well as the introduction of these products in compact and mid-size cars.

## Revenues: rapid growth in wireless communications.

Revenues rose by 96% from € 44.5 million to € 87.2 million in 1999. In the fourth quarter alone, revenues were up by 134% when compared to the same period in 1998. This increase was primarily due to the growth in wireless communications. Dialog Semiconductor's revenues in this area more than doubled to € 68 million in 1999 (prior year was € 33.4 million). Revenues from automotive electronics increased by 289% to € 7.0 million. Revenues of other industrial applications contributed € 7.8 million to total revenues, 47% more than 1998.



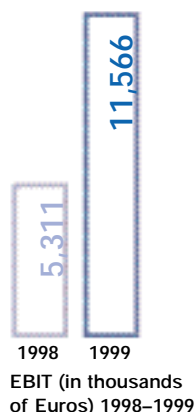


#### Income: Net income up 182%.

Earnings before interest, taxes, depreciation and amortization (EBITDA) were up by 95% in 1999 from € 7.9 million to € 15.4 million. Earnings before interest and taxes increased by 118% to € 11.6 million. These increases resulted mainly from higher revenues in the wireless communications sector (up 104% to € 68 million). Net income rose by 182% (excluding the acquired in-process technology charge of € 9.3 million) from € 2.4 million to € 6.7 million in 1999. Basic earnings per ordinary share was € 0.31.

#### Capital investment: acquisition to secure wafer supply.

In 1999 Dialog Semiconductor invested € 14.5 million primarily in new test equipment, an increase of more than 300% over the prior year. In addition, in August 1999, the Company purchased a minority interest of 19.5% in ESM, a silicon wafer foundry in Newport, Wales. This will increase the delivery security of silicon wafers – an important competitive factor considering the recent concerns relating to deliveries from Asia.

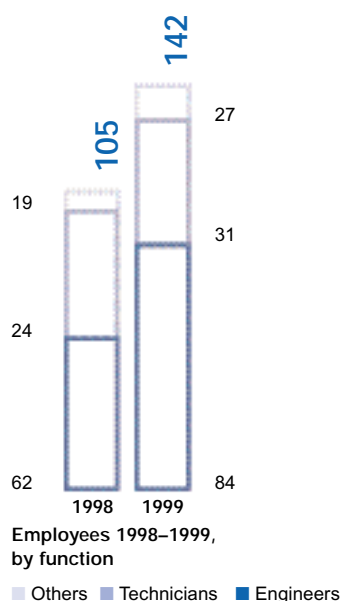


#### Transition to the Euro and to the Year 2000 successfully completed.

As of January 1, 1999 we adapted our accounting systems to record transactions in Euros. We also successfully completed the transition to the Year 2000 in all our information and communication systems. No disruptions or shutdowns were experienced in our EDP systems or in our technical equipment and machinery at any of our locations due to Y2K.

#### Employees: one third more than last year.

Dialog Semiconductor employed 142 people at the end of 1999. This represents an increase of 37 (35%) over the prior year. Of the 142 employees, 86 are located in Germany, 44 in the UK and 12 in the USA. Revenues per employee increased from € 423,600 to € 614,408. Seventy-six of the 142 employees are in research and development, an increase of 43% compared to 1998.





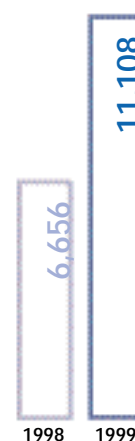
### Research and development increased significantly.

Expenditures on research and development increased by 67% in fiscal 1999 to € 11.1 million (prior year € 6.7 million) or 12.7% of revenues. The increase in R&D reflects our customers' increased demand for additional resources devoted to the development of new ASICs.

### Risk factors.

Although Dialog Semiconductor expects the wireless communications market to continue to grow rapidly in the short term, the rate of such growth may be influenced by numerous political, economic and other factors including, but not limited to, national and regional regulatory environments, general economic conditions, advances in competing telecommunication and information technologies, manufacturing capacity and the perceived health risks to mobile phone users. Any significant constraints on the growth of, or downturn in, the wireless communications market could have a material adverse effect on Dialog Semiconductor's business, results of operations and financial condition. Important risk factors are as follows:

- Dialog Semiconductor derives a substantial portion of its mobile telephone industry revenues (78% of total revenues in 1999) from a relatively small number of wireless communications manufacturers.
- The market for Dialog Semiconductor's products is characterized by continuous development and technological improvement. Therefore, Dialog Semiconductor's success is highly dependent on its ability to develop new designs and products on a cost-effective, timely basis. Dialog Semiconductor's future success is also dependent on its ability to anticipate and respond to new market trends, to rapidly implement new designs, which satisfy customers' needs, and to keep abreast of technological changes within the semiconductor industry.
- Dialog Semiconductor is currently experiencing a period of strong growth, which has placed, and will continue to place, a significant strain on its management, operational, engineering and financial resources. Dialog Semiconductor's ability to effectively manage this growth and expansion will require it to continue to implement and improve its operational, financial and management information systems, to train, motivate and manage its employees and to continue to develop, maintain and expand its production and supply relationships with selected foundries and back-end assemblers.



Expenditures on research and development  
(in thousands of Euros) 1998–1999



#### Market development: further growth expected.

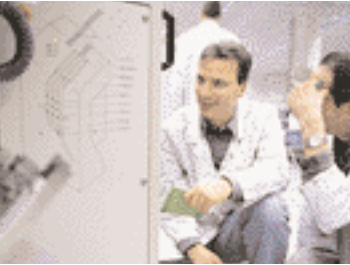
Dialog Semiconductor believes the market for semiconductors – especially application specific ICs for the wireless communications market – will continue to grow in the coming years. We expect a strong market in lesser-developed regions lacking or with an inadequate cable network infrastructure. In regions with established mobile communications services, the market will benefit from technological progress. The demand for replacement equipment will continue to grow as users replace their existing equipment with more powerful telephones. New facilities will go beyond speech transmission. “Third generation” systems will support multimedia and broadband data transmission. These facilities include wireless Internet access via the WAP standard, MP3 playback possibilities or the Bluetooth Standard (now in the development phase). Since Mixed Signal ASICs combine both analog and digital functions, they represent an excellent solution for the support of these new applications.

As a leading company in the design of application specific Mixed Signal ICs, Dialog Semiconductor commands a strong market position worldwide. In addition, we are supported by very close partnerships with market leaders in our chosen business areas. As a result, Dialog Semiconductor expects a further increase in revenues and income for the year 2000.





# Initial Public Offering and Share Price Development



## Initial public offering: Foundation for future growth.

1999 represented a milestone in the Dialog Semiconductor's history. In addition to our record operational results, 1999 was marked by our initial public offering. Our Management and Board of Directors decided to make this move to position our Company for future growth. As a result of the offering, we were able to finance the future growth of our organization while also retiring all financial liabilities.

## Dialog Semiconductor shares in high demand.

The initial public offering included 3.75 million ordinary shares from the capital increase authorized in September 1999. In addition, 1.85 million ordinary shares were offered for sale by Apax Partners.

The issue price of € 19 was set based on the order book established during the book building process. The actual demand for Dialog Semiconductor shares generated during the book building process by far exceeded supply, and the subscription was oversubscribed three times. A total of 19% of the total issue went to private investors and institutional investors in Germany with the remainder going mainly to investors (both private and institutional) in the UK and the US.

## Employee participation in the purchase of Dialog Semiconductor shares.

In addition to the stock already owned by management and employees, we offered employees at all levels the opportunity to purchase Dialog Semiconductor shares at the IPO price. As of December 31, 1999 employees, management and directors own 8.2% of Dialog Semiconductor's share capital.

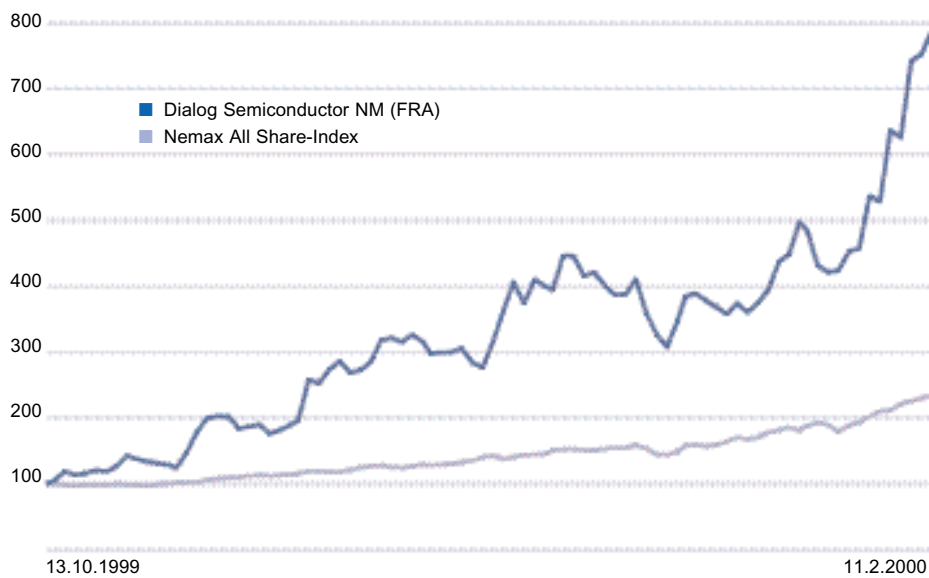




### Successful trading start for Dialog Semiconductor shares.

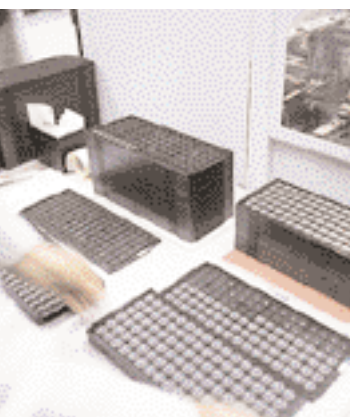
Although Dialog Semiconductor's shares have only been traded on the Neuer Markt and on the EASDAQ since October 13, 1999, it was one of the most successful stock on these stock exchanges in 1999.

Share price development until February 11th, 2000 compared to NEMAX All Share-Index



### Share data as of December 30, 1999

Security Identification Number (SIN)	Neuer Markt: 927 200
Symbols	Neuer Markt: DLG EASDAQ: DLGS
Stock Exchanges	Frankfurter Wertpapierbörse (Neuer Markt) EASDAQ, Brussels
Number of shares as of Dec. 31, 1999	21,034,465
Share price as of Dec. 30, 1999 (in €)	73.50
High as of Dec. 30, 1999 (in €)	89.00
Low as of Dec. 30, 1999 (in €)	18.90
First trading day (in €)	19.20
Performance since offering	286.8%
Trading volume per day (Average 1999)	41,666
Market capitalization (in millions of €)	1,546
Basic earnings per share 1999 (in €)	0.31



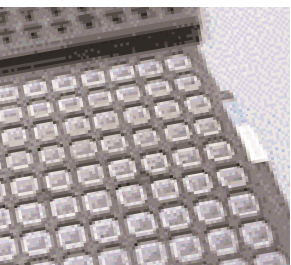


## Overview.

We are a leading supplier of types of silicon chips called mixed signal ASICs, or application specific integrated circuits, to the wireless communications market. Our core competence is the design of complex analog and digital (mixed signal) integrated circuits and the ability to rapidly deliver qualified and tested products directly to the customer. We draw on our team of highly skilled engineers and an extensive library of ASIC design and know-how to respond to the demands of our customers. Utilizing our mixed signal expertise, we have focused on two areas of the mobile telephone market, power management and Audio CODEC, where these design skills are critical for success.

We have successfully developed a strategy of outsourcing the manufacture and assembly of our ASIC products. We have close relationships with leading semiconductor foundries who maintain state-of-the-art facilities and allow us to deliver high quality products without investing the substantial amounts of capital required for an in-house foundry. We control the whole production process and ensure quality through in-house testing of final product before delivery to the customer.

Following return of the assembled products from its assemblers, we test our products before delivery to a customer. No product is delivered to a customer unless it has been tested. This rigorous testing approach allows us to ensure overall quality control of our manufactured products. The test programs developed by our test engineers are based upon specifications determined by the individual customers and are developed in parallel with the design.





## Wireless Communications Market:

### Continued rapid growth.

The wireless communications market continued to experience rapid growth in 1999 as technological developments made products and services more available and increasingly affordable. In 1999, worldwide wireless services reached approximately 426 million subscribers. According to the latest available information from Dataquest, the number of subscribers is forecast to more than double – to 863 million – by 2003. Even today, the market for wireless communications – based on units of equipment sold – is around twice the market for personal computers (source: IC Insights). The market volume in 1999 was approximately US\$47 billion.

### Dialog Semiconductor benefits from growth in wireless communications.

The business sector of wireless communications – the major pillar of our Company – was very strong during 1999. Revenues increased by 104% to € 68 million. Revenues from wireless communications applications accounted for 78% of total revenues. The primary reason for this increase was the growth in demand for mixed signal ASICs. Dialog Semiconductor benefited from strong sales realized by customers such as Ericsson and Siemens. We provided mixed signal ASICs (power management or audio CODEC) for the Ericsson T28s and the Siemens S25 mobile telephones. In total Dialog Semiconductor had at least one ASIC in 40 million mobile telephones in 1999.

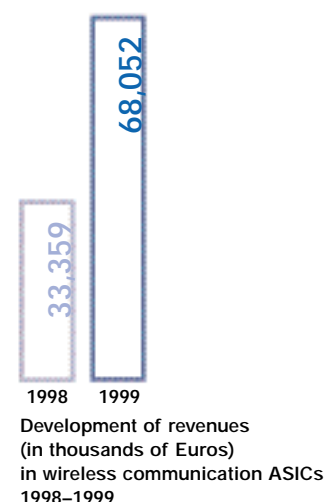
### Our core competence: cost effective and powerful system solutions.

Our core business continues to revolve around the development and delivery of cost effective ASICs. In parallel, we develop new applications. In this way we will be better equipped to meet the demands of future generations of wireless communications systems being able to offer more sophisticated integrated analog and digital capabilities.

### Well equipped for the third generation of wireless communications.

1999 was also the year Dialog Semiconductor launched development programs for third generation mobile telephone ASICs. The main objective for third generation wireless communication systems is the support of broadband applications. Examples of high volume data transmission include videoconferences, wireless Internet access, and MP3 playback possibilities. Our goal is to be the leading manufacturer of ASICs for this market at the start of the third generation of wireless communications.

Dialog Semiconductor is among the few companies worldwide that possess the technology necessary for both low power/low voltage applications and the integration of mixed signal capabilities on a single ASIC. Combined with our expertise in DSP (digital signal processing), we continue to be an important strategic partner for leading equipment manufacturers in the development and delivery of advanced mixed signal solutions.

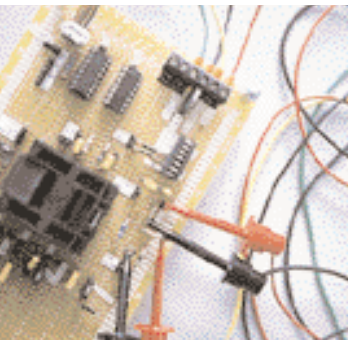


### Wireless Communication ASICs.

Our power management chips aim to maximize the supply and consumption of power, primarily affecting the total talk and standby times of mobile telephones. Audio CODEC is the critical interface between outside world analog signals (such as the human voice) and the digital data processing inside a mobile phone. We are developing relationships in the fast growing automotive electronics sector where mixed signal expertise is especially sought after. We intend to expand our relationships with key industry leaders such as Ericsson and Siemens while developing relationships with additional selected customers. These relationships allow us to identify market needs and broaden the market for our products.

### Audio CODECs.

The Audio CODEC subsystem is the main contributor to the voice quality of a mobile phone. The Audio CODEC converts the digital signal received from the baseband subsystem into an analog signal that is fed to the loudspeaker and also converts the analog signal from the microphone into a digital code.



Our Audio CODEC ASICs are specifically designed for low voltage and low power applications using a minimum area of silicon. Consequently, the parts have been migrated to higher functionality by using smaller geometries which resulted in smaller die sizes and reduced costs. In order to satisfy a variety of ASIC requirements, we have designed a number of analog-digital converters using a variety of delta-sigma modulators. These modulators are circuits that convert analog signals into a bit stream (a circuit which uses a specific technique for converting analog signals to digital signals), enabling the bit stream to be processed in the digital domain. In our view, analog-digital converters provide an excellent compromise between performance, complexity and stability.

To enable handsets to interface with the outside world, we have also designed a variety of microphone amplifiers for ceramic, piezo and dynamic transducers, which are devices that convert energy (such as pressure or temperature) into an electronic signal. These designs often have programmable gain, typically to a maximum of 40 decibels in 16 or 32 steps, in order to maximize low noise performance. Additionally, pre-amplification and filtering/noise shaping can also be included. Similarly, loudspeaker or earpiece interfaces usually involve similar gain and filtering functions that allow for the driving of piezo or dynamic transducers. For lowest cost solutions, we have introduced 16 Ohm dynamic transducers, as used in personal stereo headphones, with low impedance.





### Power management.

The typical cells we use in our power management products include voltage regulators, charging/discharging controls, DC-DC converters, power-on reset, under/over voltage lockouts, thermal shutdowns, reverse battery protection, which protects an ASIC from being destroyed when supplied with the wrong polarity. We have combined these functions on a single chip. We have a library of standard designs for power management products which can be rapidly modified to meet a customer's specific needs.

Our voltage regulators are driven by a trimmable master reference with quiescent current optimised stabilization under varying load conditions. This basic cell also incorporates an overvoltage clamp to restrict input voltages to acceptable limits and an error amplifier and has a powerdown mode.

Our designs are low drop out (LDO) voltage regulators which are a key element in power management ASICs. The LDOs determine the minimum voltage required from the battery to operate the system. We have extensive experience in the design of low on resistance pass transistors which, by generating a stable supply of voltage, have a major influence on the low drop out behavior. For further optimization, we provide bonding techniques to insure minimum voltage drop out between silicon and the application printed circuit board (PCB).

DC-DC conversion can be performed by different solutions, with each operating at good efficiencies even when supplying low currents and achieving low quiescent current when under no load. If needed, DC-DC converters can incorporate current or voltage sensing as a maintenance control function of the converter. The designs can be run in synchronous (without start and stop bits) or asynchronous (with start and stop bits) mode using pulse wide modulation (PWM), pulse frequency modulation (PFM) or both.

Depending on battery technologies (nickel hydride, nickel cadmium or lithium), we can provide tailored charging schemes including monitor functions for current and voltage. In both methods, monitor functions are integrated for safety reasons, over and under voltage detection and charger fault conditions.

Most of our power management systems have a variety of safeguards. These typically include power-on reset cells which monitor critical parameters. Under-voltage protects the phone from operating when there is insufficient power available. Over-voltage can protect the phone from supply transients, an example of which is when the battery is removed while charging is taking place and there is a momentary rapid rise in supply. Protection also can be added in fault situations outside the battery's normal safe areas of operation.

## Business Automotive ASICs



### Complex automotive electronics behind increasing demand for semiconductors.

Dataquest projects a compound annual growth rate of 10% in the market for automotive semiconductors through 2002 due to increasing demand for greater comfort, safety, driver information and performance. The market volume will have then reached roughly US\$13 billion. Further, Dataquest predicts the semiconductor content per vehicle will grow on average to US\$ 222 in 2002 from US\$ 153 in 1998.

### Automotive ASICs: constant contribution to revenues.

Revenues from automotive ASICs reached € 7 million in 1999. This represented significant growth for the business sector of automotive ASICs when compared to 1998. As a percentage of revenues, automotive ASICs doubled from 4% in 1998 to 8% in 1999. This twofold increase as a percentage of revenues translates to an absolute increase in revenues of 289%. Our principal customers in this area are Bosch, Mannesmann VDO, Temic DaimlerChrysler and TRW.

### New demands for automotive safety and comfort electronics.

To date, we have concentrated our efforts in the areas of safety and dashboard semiconductor products. For TEMIC DaimlerChrysler we produce signal conditioning ASICs. These ASICs, when combined with micro-mechanical chips, form the principal components of the sensors used in airbag systems. These sensors then relay electronic signals to a control unit, which determines deployment of the airbag. We believe that, due to increased consumer awareness of automotive safety, growth in the use of sensors in cars will continue as safety systems become more sophisticated.

Automotive dashboards are now used to deliver more information and data to drivers for safety and convenience. We produce a variety of dashboard control ASICs for customers such as Bosch and TRW, that relay information from various on-board sensors (such as fuel level, oil pressure, speed and engine heat) through micro controllers to the dashboard. Growth trends in this area are predicted to include information systems for road and traffic conditions, emergency calling systems and links to wider forms of communications such as the Internet, on-board navigation systems and new wireless communications applications. As a result, we believe there will be increased demand for mixed signal ASICs in this sector.



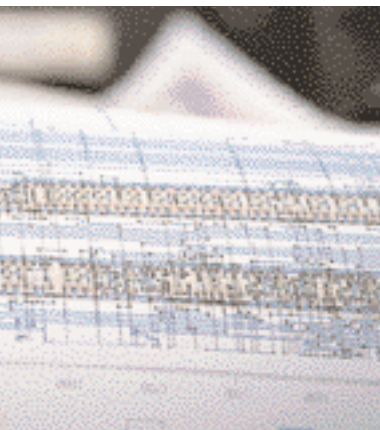
Development of revenues  
(in thousands of Euros)  
in Automotive ASICs  
1998–1999

Completion of the product line.

In addition to providing analog and mixed signal design expertise to the wireless communications and automotive markets, we also have a relatively small but established product range consisting of dimming motor control, sensor and power management ASICs for use in lighting systems and ASICs for use in data communications. We currently have an exclusive supply agreement with Tridonic, a large manufacturer of lighting systems and we produce ASICs in data communications for Adtran. Revenues in this area reached € 7.8 million or 9% of total revenues in 1999. While we intend to maintain our existing product base in the lighting control and data communications sectors, we have no current plans for expansion.



Development of revenues  
(in thousands of Euros)  
in Industrial ASICs  
1998–1999



# Employees

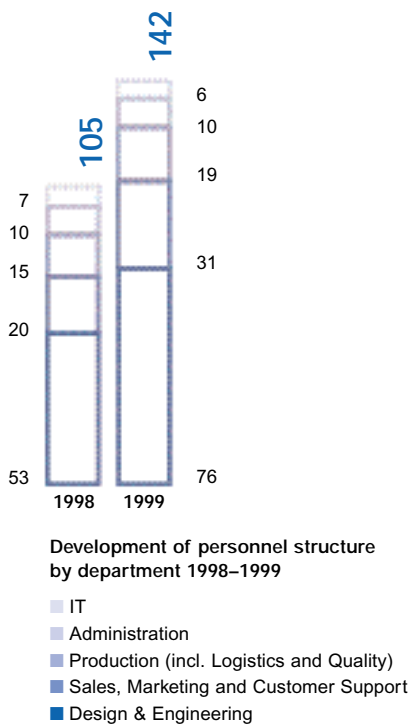
## Positive personnel developments.

Our employees are the heart of Dialog Semiconductor. They are the guarantee of the quality of our products and the innovative capabilities of the entire Company. As of December 31, 1999 we employed 142 employees (37 more than at year-end 1998) at our locations in Kirchheim/Nabern, Heidelberg, Munich (Germany), Swindon (UK) and Clinton (New Jersey, USA). Of the total number, 76 (54% of all employees) are engaged in design and engineering. Our team is highly motivated and well qualified. Together they share more than 400 years of combined experience in the design of mixed signal ASICs.

## Dialog Semiconductor: an exciting employment opportunity.

The ongoing success of our Company depends on our ability to continually improve technologies and to introduce new product generations. Our employees play the most important role in this challenge. Only qualified design, test and product engineers with the necessary experience in our industry are capable of satisfying our customers' demands in respect of quality and time to market. We are, therefore, proud that our turnover rate is far below industry average. The majority of our engineers have been with us for five years or more. More than 20% of our employees have been with Dialog Semiconductor for over ten years.

To further develop our employees and establish strong communication and feedback, we have implemented a worldwide employee appraisal program. The goal of this program is to assist managers to assess employee's career development and potential. In addition, promoting and documenting employee training – whether via external or in-house courses – is part of our ISO 9000 quality procedures.



### Successful employee participation in the IPO.

At the time of the IPO, all employees were given the opportunity to acquire shares in our Company at the issue price. Employees at all levels took advantage of this offer. Today over 8% of our total share capital is held by employees. In addition, we have granted stock options to employees which will vest over time after they have met eligibility requirements. The share and stock option plans have been successful in rewarding and motivating existing employees and are a valuable recruitment tool in attracting new staff.

### Recruitment campaign for new engineers.

To recruit qualified new staff we started a worldwide hiring campaign in 1999. Employment opportunities are being offered at all our locations in Germany, the UK and in the USA. We are primarily interested in acquiring experienced and highly qualified engineers at all levels of our design and operations activities.



# Research and Development



## R&D: backbone of our success.

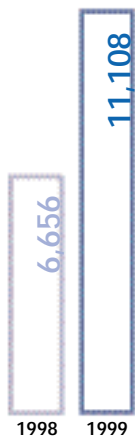
The market for wireless communications applications is evolving at a rapid pace. Leading equipment manufacturers bring a new range of mobile telephones to market about twice a year. The success of a semiconductor manufacturer is therefore dependent on its capability to react to the ever-changing demands of its customers with the development of new designs. For this reason, research and development plays a significant role at Dialog Semiconductor.

## R&D expenditure increased in 1999.

Research and development expenditure increased by 66.9% from € 6.7 million to € 11.1 million in 1999. This reflects the increase in demand by our major customers for additional research input in the development of new products. In addition, we added personnel in the research and development department – 76 employees at the end of 1999, up from 53 as of the end of 1998.

## New developments based on our customers' needs.

Our research and development expenses arise primarily from design and construction related costs in connection with the development of new products for customers and upgrading of existing products for customers. Dialog Semiconductor's research and development is for the most part driven by the particular product needs of its customers. It is part of our business strategy to develop products tailored to specific customer requirements. Most significant in 1999 were our product developments for the Ericsson T28s and the Siemens S25 phones. These top of the range products feature Dialog Semiconductor ASICs for power management or for the Audio CODEC system.



Development of expenditures  
on R&D (in thousand of Euros)  
1998–1999



#### **We are working towards the future of wireless communications.**

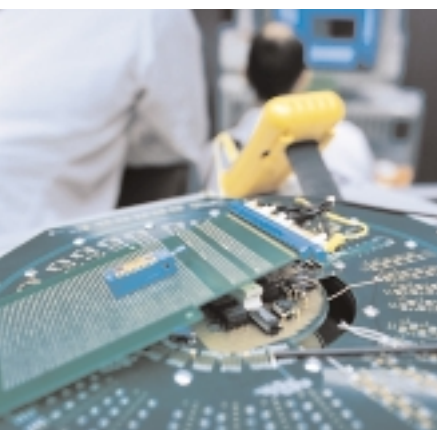
Just as it is today, the core of our future R&D will be in the development of new ASIC designs for the wireless communications market. While the recent trend has focused on size and power, the coming years will see a growing emphasis placed on new features. The increasing convergence of information and communications technologies will be at the forefront of this trend.

#### **Involvement in the “wireless Internet”.**

The “wireless Internet” is one of the most important innovations in the mobile communication industry. This has been made possible by the new WAP technology (Wireless Application Protocol). Specially prepared data, graphics and photographs can be transmitted via the Internet to a mobile telephone display. This new standard will significantly affect the demand for mobile telephones in the near future. WAP will also play an important role for Dialog Semiconductor.

#### **Implementation of the new UMTS Standard soon upon us.**

Developments in wireless communications equipment will all belong to the third generation of wireless communications standards. The UMTS Standard (Universal Mobile Telecommunications System) will replace the GSM Standard in the long run and will function worldwide. This Standard will clear the way for future mobile audio, video and Internet applications. The UMTS-Standard is scheduled for introduction in Japan in 2001 and in Europe and the USA by 2003. During 1999, Dialog Semiconductor worked on first prototypes for the third generation of mobile telecommunications systems. Our process technologies have been refocused to meet the demands of future mobile communications systems. The goal for geometric processes is now 0.35 $\mu$  which will enable even more integration of digital and analog capabilities within an ASIC.





# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Results of Operations

The following table sets forth historical and pro forma consolidated statements of income for the Company and Dialogue Semiconductors Limited and its subsidiaries (together, the "Predecessor Business") in thousands of Euros and as a percentage of revenues for the years indicated (1998 on a pro forma basis).

	Successor Company <sup>1)</sup>				Predecessor Business <sup>2)</sup>	
	Year ended December 31,				Year ended December 31,	
	1999		1998 <sup>3)</sup> (unaudited pro forma)		1997	
	€	%	€	%	€	%
Revenues	87,246	100.0	44,478	100.0	38,528	100.0
Cost of sales	(56,749)	(65.0)	(25,429)	(57.2)	(26,728)	(69.4)
<b>Gross margin</b>	<b>30,497</b>	<b>35.0</b>	<b>19,049</b>	<b>42.8</b>	<b>11,800</b>	<b>30.6</b>
Research and development	(11,108)	(12.7)	(6,656)	(15.0)	(3,773)	(9.8)
Selling, general and administrative	(6,586)	(7.6)	(6,125)	(13.8)	(5,728)	(14.9)
Amortization of goodwill and intangible assets	(1,237)	(1.4)	(957)	(2.1)	(15)	—
Acquired in-process research and development	—	—	(9,300)	(20.9)	—	—
<b>Operating profit (loss)</b>	<b>11,566</b>	<b>13.3</b>	<b>(3,989)</b>	<b>(9.0)</b>	<b>2,284</b>	<b>5.9</b>
Financial income (expense), net	(316)	(0.4)	(218)	(0.5)	(183)	(0.4)
Income taxes	(4,570)	(5.2)	(2,721)	(6.1)	(1,078)	(2.8)
<b>Net income (loss)</b>	<b>6,680</b>	<b>7.7</b>	<b>(6,928)</b>	<b>(15.6)</b>	<b>1,023</b>	<b>2.7</b>

<sup>1)</sup> Dialog Semiconductor Plc and its subsidiaries from and after the acquisition effective March 1, 1998.

<sup>2)</sup> Dialogue Semiconductors Limited and its subsidiaries prior to the acquisition effective March 1, 1998.

<sup>3)</sup> The consolidated pro forma statement of income gives effect to the acquisition by the Company of the Predecessor Business on January 1, 1998. The Predecessor Business and Company periods which comprise the pro forma consolidated statement of income for the fiscal year ended December 31, 1998 are presented in the audited consolidated financial statements.

The Company has experienced considerable growth in revenues during the period between January 1, 1996 and December 31, 1999. This growth has been attributable to the strategic decision by management in 1996 to focus primarily on the design and delivery of semiconductor products for the rapidly expanding wireless communications industry. Since 1996, the Company's revenues are principally derived from sales of Mixed Signal ASICs to targeted customers in this industry.

Revenues from the Company's wireless communications applications accounted for 78% and 75% of the Company's total revenues for 1999 and 1998.

# Year Ended December 31, 1999 Compared to Pro Forma 1998

## Revenues.

Revenues increased 96% to € 87.2 million for the year ended December 31, 1999 compared with pro forma 1998 revenues of € 44.5 million. This increase in revenues in 1999 was primarily due to greater sales volumes resulting from an industry-wide increase in demand for mobile communications products combined with a variety of new designs in production in response to customer requirements. The gains in volumes were partially offset by lower prices demanded from existing customers as they increased the size of their orders and as designs matured.

## Cost of Sales.

Cost of sales consists of the costs of outsourcing production and assembly, personnel costs and applicable overhead and depreciation of test and other equipment. Cost of sales increased from € 25.4 million for the pro forma year ended December 31, 1998 to € 56.7 million for the year ended December 31, 1999. Cost of sales as a percentage of revenues increased during this period from 57.2% for the pro forma year ended December 31, 1998 to 65.0% for the year ended December 31, 1999. The higher cost of sales as a percentage of revenues in 1999 resulted from lower per unit sales prices as order sizes increased and as designs matured.

## Gross Margin.

Gross margin increased from € 19.0 million for the pro forma year ended December 31, 1998 to € 30.5 million for the year ended December 31, 1999. As a percentage of revenues, however, gross margin decreased from 42.8% for the pro forma year ended December 31, 1998 to 35.0% for the year ended December 31, 1999. This lower gross margin as a percentage of revenues was due to the lower unit prices demanded by customers as order sizes increased and designs matured as well as higher cost of sales due to start up costs incurred in connection with the launch of new products.

## Research and Development.

Research and development expenses increased 66.9% from € 6.7 million for the pro forma year ended December 31, 1998 to € 11.1 million for the year ended December 31, 1999. As a percentage of revenues, however, research and development expenses decreased for this period from 15.0% for the pro forma year ended December 31, 1998 to 12.7% for the year ended December 31, 1999. The decrease in research and development expenses as a percentage of revenues resulted from the spreading of these costs over a greater revenue base. The absolute increase in research and development expenses reflected the increased demand from key customers for us to devote further resources to assist in the development of new products for them. We increased research and development headcount from 53 at December 31, 1998 to 76 at December 31, 1999. We expect research and development expenses to continue to increase in absolute terms in future periods as we add additional design and engineering staff.

### **Selling, General and Administrative.**

Selling, general and administrative expenses consist primarily of salaries, travel expenses and costs associated with advertising and other marketing efforts, and personnel and support costs for our finance, human resources, information systems and other management departments. Selling, general and administrative expenses increased 7.5% from € 6.1 million for the pro forma year ended December 31, 1998 to € 6.6 million for the year ended December 31, 1999. As a percentage of revenues, selling, general and administrative expenses decreased from 13.8% for the pro forma year ended December 31, 1998 to 7.6% for the year ended December 31, 1999. These decreases are primarily due to lower selling expenses as we began to hire our own salesforce. We expect selling, general and administrative expenses to increase generally in future periods as we add additional sales and administrative personnel, increase IT systems support and incur greater legal and accounting expenses as a public company.

### **Amortization of Goodwill and Intangible Assets.**

We recorded amortization expense of € 1.0 million for the pro forma year ended December 31, 1998 and € 1.2 million for the year ended December 31, 1999. In both cases, the amortization related primarily to the goodwill and other intangible assets recorded as part of the acquisition of the Predecessor. Goodwill recognized in connection with the acquisition is being amortized over 15 years, the expected period of benefit.

### **Acquired In-process Research and Development.**

In connection with the acquisition on March 1, 1998, we allocated € 9.3 million of the purchase price to acquired in-process technology, which we expensed.

### **Operating Profit (Loss).**

We reported an operating loss of € 4.0 million for the pro forma year ended December 31, 1998 compared with an operating profit of € 11.6 million for the year ended December 31, 1999. This change in operating profit in 1999 was primarily due to greater sales volumes in 1999 and to the non-recurring charge relating to acquired in-process technology in 1998.

### **Financial Expense, net.**

Financial expense, net consists primarily of interest income from our investments (primarily short term deposits), interest expense on our short-term borrowings and foreign currency transaction gains or losses. Financial expense, net increased from expenses of € 0.2 million for the pro forma year ended December 31, 1998 to expenses of € 0.3 million for the year ended December 31, 1999. This increase in financial expense, net in 1999 is primarily due to interest expense on short term borrowings and recognized foreign exchange losses from the year-end valuation of foreign currency receivables and payables which more than offset an increase in interest income on cash balances following our initial public offering in October 1999.



#### Income Taxes.

We recognized income tax expense of € 2.7 million for the pro forma year ended December 31, 1998 or an effective tax rate of 45.4% (before amortization of goodwill and other intangible assets and the charge for acquired in-process technology). For the year ended December 31, 1999, income tax expense amounted to € 4.6 million or an effective tax rate of 37.6% (before amortization of goodwill and other intangible assets). This decrease in the effective tax rate for the year ended December 31, 1999 reflects the fact that we applied the German distributed corporate income tax rate of 30% to 1999 earnings of our German subsidiary compared to the undistributed corporate income tax of 45%, which applied in 1998. We plan to distribute the earnings of our German subsidiary to the parent company in future periods.

#### Net Income (Loss).

For the reasons described above, we reported a net loss of € 6.9 million for the pro forma year period ended December 31, 1998 compared with net income of € 6.7 million for the year ended December 31, 1999.

# Pro Forma 1998

## Compared to Year Ended December 31, 1997

### Revenues.

Revenues increased 15.4% from € 38.5 million for the year ended December 31, 1997 to € 44.5 million for the pro forma year ended December 31, 1998 during a period when semiconductor industry revenues generally decreased. This increase in revenues in 1998 is primarily due to increased demand from the mobile communications market and our introduction of new products in the automotive sector. However, increased production volume, particularly for semiconductors used in the mobile communications sector, also created downward pricing pressure which, although moderate in the first nine months of 1998, increased in the final quarter of 1998. As discussed above, this pressure on prices continued during 1999.

### Cost of Sales.

Cost of sales decreased from € 26.7 million for the year ended December 31, 1997 to € 25.4 million for the pro forma year ended December 31, 1998. Cost of sales as a percentage of revenues decreased to 57.2% for the pro forma year ended December 31, 1998 from 69.4% in 1997. This decrease in cost of sales as a percentage of revenues in 1998 primarily reflects the spreading of these costs over a greater revenue base and better production yields.

### Gross Margin.

Gross margin increased from € 11.8 million for the year ended December 31, 1997 to € 19.0 million for the pro forma year ended December 31, 1998. As a percentage of revenues, gross margin increased from 30.6% for the year ended December 31, 1997 to 42.8% for pro forma 1998. These increases were primarily due to the startup of certain new products as a result of a new strategy we devised in 1996. The introduction of these new products resulted in increased production volumes and reduced pricing pressure for the first nine months of 1998. As a result, revenues increased at a higher rate than cost of sales.

### Research and Development.

Research and development expenses increased from € 3.8 million for the year ended December 31, 1997 to € 6.7 million for the pro forma year ended December 31, 1998. As a percentage of revenues, research and development expenses increased from 9.8% in 1997 to 15.0% (pro forma) in 1998. The increase in research and development expenses reflected the increased demand by key customers for us to devote further resources to assist in the development of new products for these customers.

#### **Selling, General and Administrative.**

Selling, general and administrative expenses increased 6.9% from € 5.7 million for the year ended December 31, 1997 to € 6.1 million for the pro forma year ended December 31, 1998. The increase in expense principally resulted from expenditures on administrative infrastructure to support our growing business operations and sales staff, higher legal costs associated with the acquisition of the Predecessor and the resulting corporate reorganization. These expenditures were offset by lower overall selling expenses and greater cost efficiencies due to the early effects of the establishment of our own salesforce. As a percentage of revenues, sales and marketing expenses decreased from 11.6% in 1997 to 7.9% (pro forma) in 1998.

#### **Amortization of Goodwill and Intangible Assets.**

We recorded amortization expenses for the pro forma year ended December 31, 1998 of € 1.0 million compared with € 15,000 for the year ended December 31, 1997. This significant increase primarily related to the goodwill and intangible assets recorded as part of the acquisition of the Predecessor on March 1, 1998.

#### **Acquired In-process Research and Development.**

In connection with the acquisition on March 1, 1998, we allocated € 9.3 million of the purchase price to acquired in-process technology, which we expensed.

#### **Operating Profit (Loss).**

We reported operating profit of € 2.3 million for the year ended December 31, 1997 compared with an operating loss of € 4.0 million the for pro forma year ended December 31, 1998. This decrease was principally due to the acquired in-process technology charge and amortization of goodwill.

#### **Financial Expense, net.**

Financial expense, net remained unchanged at € 0.2 million for the year ended December 31, 1997 and for the pro forma year ended December 31, 1998, and represents interest expense on short-term borrowings.

#### Income Taxes.

We recognized income tax expense of € 1.1 million for the year ended December 31, 1997 or an effective tax rate of 51.3%. For the pro forma year ended December 31, 1998, income tax expense amounted to € 2.7 million or an effective tax rate of 45.4% (before goodwill and other intangible asset amortization and the charge for acquired in-process technology). The higher effective rate of tax for the year ended December 31, 1997 reflected a higher contribution of earnings from German operations in that year which, in turn, was taxed at a higher rate, as well as a higher marginal corporate surcharge levied in Germany in 1997 compared to 1998.

#### Net Income (Loss).

For the reasons described above we reported net income of € 1.0 million for the year ended December 31, 1997 compared with a net loss of € 6.9 million for the pro forma year ended December 31, 1998.

# Liquidity and Capital Resources

## Cash Flows.

Cash used for operating activities, which includes depreciation and amortization, was € 0.9 million in 1999. In 1999, we used cash to finance greater working capital requirements and higher accounts receivable and inventory levels as our sales volumes increased. Cash from operating activities was sufficient to finance our working capital requirements in 1997 and 1998.

Cash used for investing activities was € 28.8 million in 1999, € 0.4 million for the period from January 1, 1998 to February 28, 1998 and € 31.2 million for the period from March 1, 1998 to December 31, 1998. In 1999, we invested a total of € 12.2 million in cash to acquire a 19.47% equity interest in, and make a loan to, ESM. In addition, in 1999 we invested € 14.5 million in property, plant and equipment, primarily new test equipment. In 1998, € 28.0 million in cash was used to pay for our acquisition of the Predecessor. See "Capital Expenditures and Investments". For more information on the loan to ESM see Note 6 to the Notes to the Audited Consolidated Financial Statements.

In October 1999, we received € 59.2 million in net cash proceeds from our initial public offering in Germany. Of this amount we used € 19.6 million to redeem all of our then outstanding cumulative redeemable preference shares. We also used approximately € 12.2 million of the net offering proceeds to repay the short-term borrowings under a revolving line of credit with Deutsche Bank AG that we incurred in connection with our investment in ESM. We also used approximately € 3.4 million of the net offering proceeds to repay all outstanding amounts then due under an overdraft facility with Deutsche Bank.

In 1998, we received € 28.0 million in net cash proceeds from a private offering of securities to Apax, Ericsson, Adtran and certain members of management. These contributions consisted of the subscription for approximately € 5.3 million of our ordinary shares, additional paid-in capital of € 5.3 million and the subscription for approximately € 17.5 million of cumulative redeemable preference shares. At the time of the acquisition, we also repaid € 3.8 million of the Predecessor's indebtedness to DaimlerChrysler AG primarily through an increase in short term borrowings.

At December 31, 1999 we had € 11.3 million in cash and cash equivalents, and had a working capital surplus of € 26.7 million, as compared to € 3.0 million in cash and cash equivalents, and a working capital surplus of € 2.9 million at December 31, 1998.

### Liquidity.

Our primary sources of liquidity have been cash from operations as well as cash from the issuance of ordinary shares, cumulative redeemable preference shares and from short-term borrowings. As of December 31, 1999 we had no long-term debt.

We have a € 12.8 million short-term credit facility with Deutsche Bank that bears interest at a rate of the lower of EURIBOR + 0.75% or 6.0% per annum. At December 31, 1999 we had no amounts outstanding under this facility.

The investment in and loan to ESM were financed by short-term borrowings under an additional revolving line of credit with Deutsche Bank. We used a portion of the net proceeds of our initial public offering to repay all outstanding amounts under this revolving facility.

### Capital Expenditures and Investments.

Our capital expenditures for the year ended December 31, 1999 were € 14.5 million and for the pro forma year ended December 31, 1998 were € 3.3 million. For the period from January 1, 1998 to February 28, 1998 and for the period from March 1, 1998 to December 31, 1998, capital expenditures were € 0.4 million and € 2.9 million, respectively. Capital expenditures were € 1.0 million for the year ended December 31, 1997. Our capital expenditures in 1999, 1998 and 1997 consisted primarily of purchasing new or replacement test systems, tooling equipment, handling systems and other plant and equipment in the ordinary course of our business. The significant increase in capital expenditures in 1999 primarily reflects the purchase of seven additional testing machines, which we installed in 1999. In addition, we purchased a minority stake in ESM in 1999. We expect that we will make capital expenditures totalling approximately € 17.5 million in 2000 (primarily for new machinery and equipment). In future periods, we may also make strategic investments or acquisitions in connection with our plans to expand our business internationally. However, as of the date of this annual report we are not negotiating with any third party and have not entered into any binding contract to make any such strategic acquisition or investment.

### Dividends.

Neither we nor the Predecessor have paid dividends in the years ended December 31, 1999, 1998 and 1997. We do not currently plan to pay dividends in the foreseeable future.

#### Management's responsibility for financial reporting.

The accompanying financial statements and related notes of Dialog Semiconductor Plc were prepared by management, which has the primary responsibility for the integrity of the financial information therein. The statements were prepared in conformity with United States generally accepted accounting principles ("U.S. GAAP") and include amounts which are necessarily based on management's judgement. Financial information presented elsewhere in this report is consistent with that in the financial statements.

We have installed effective internal controls and monitoring systems to guarantee compliance with the accounting principles and the adequacy of reporting. They include the use of uniform guidelines group-wide, the use of reliable software, the selection and training of qualified personnel.

The financial statements have been audited by the Company's independent auditor, whose opinion is expressed on the following page. Their audit was conducted in accordance with generally accepted auditing standards, and as such, they obtained an understanding of the Company's systems of internal accounting controls and conducted such tests and related procedures as they deemed necessary to arrive at an opinion on the fairness of presentation of the financial statements.

Together with the independent auditors, the Board of Director's Audit Committee examined the consolidated financial statements including the notes and reviewed the documentation related to the financial statements.

Roland Pudelko  
CEO & President

Martin Klöble  
Vice President, Finance & Controlling







# Independent Auditors' Report

## To the Board of Directors and Shareholders of Dialog Semiconductor Plc:

We have audited the accompanying consolidated balance sheets of Dialog Semiconductor Plc and subsidiaries (as defined in Note 1 to the Consolidated Financial Statements) as of December 31, 1999, 1998 and 1997 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year ended December 31, 1999 and for the period March 1, 1998 to December 31, 1998, the Successor periods, and for the period January 1, 1998 to February 28, 1998 and for the year ended December 31, 1997, the Predecessor periods. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with United States generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dialog Semiconductor Plc and subsidiaries as of December 31, 1999, 1998 and 1997, and the results of their operations and their cash flows for the year ended December 31, 1999 and for the period March 1, 1998 to December 31, 1998, the Successor periods, and for the period January 1, 1998 to February 28, 1998 and for the year ended December 31, 1997, the Predecessor periods, in conformity with United States generally accepted accounting principles.

As more fully described in Note 1 to the Consolidated Financial Statements, Dialog Semiconductor Plc acquired the Dialogue Semiconductor activities of Daimler-Benz AG (now DaimlerChrysler AG) as of March 1, 1998 in a business combination accounted for as a purchase. As a result of the acquisition, the consolidated financial statements for the Successor periods are presented on a different basis of accounting than that of the Predecessor periods, and therefore are not directly comparable.

Stuttgart, March 3, 2000

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft



(Sheehan)

CPA



(Kiechle)

Wirtschaftsprüfer

# Consolidated Statements of Income

(In thousands of €, except per share data)	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Revenues	87,246	38,197	6,281	38,528
Cost of sales	(56,749)	(21,896)	(3,533)	(26,728)
<b>Gross margin</b>	<b>30,497</b>	<b>16,301</b>	<b>2,748</b>	<b>11,800</b>
Research and development	(11,108)	(5,542)	(1,114)	(3,773)
Selling, general and administrative	(6,586)	(5,077)	(1,048)	(5,728)
Amortization of goodwill and intangible assets	(1,237)	(802)	(3)	(15)
Acquired in-process research and development	—	(9,300)	—	—
<b>Operating profit (loss)</b>	<b>11,566</b>	<b>(4,420)</b>	<b>583</b>	<b>2,284</b>
Financial income (expense), net	(316)	(140)	(78)	(183)
Income taxes	(4,570)	(2,430)	(291)	(1,078)
<b>Net income (loss)</b>	<b>6,680</b>	<b>(6,990)</b>	<b>214</b>	<b>1,023</b>
<b>Earnings per share</b>				
Basic earnings (loss) per share	0.31	(0.46)		
Diluted earnings (loss) per share	0.30	(0.46)		
<b>Weighted average number of shares (in thousands)</b>				
Basic	17,990	17,284		
Diluted	18,895	17,284		

The accompanying notes are an integral part of these Consolidated Financial Statements.

All 1998 and 1997 balances have been restated from Deutsche Mark into Euro using the exchange rate as of January 1, 1999.

# Consolidated Balance Sheets

(In thousands of €)	Successor		Predecessor
	At December 31,		
	1999	1998	1997
<b>ASSETS</b>			
Cash and cash equivalents	11,257	2,958	1,105
Accounts receivable, net of allowance for doubtful accounts of 298, 155, and 76 in 1999, 1998 and 1997, respectively	21,946	7,548	8,402
Inventories	10,019	3,496	2,488
Deferred taxes	38	44	715
Other current assets	5,101	661	852
<b>Current assets</b>	<b>48,361</b>	<b>14,707</b>	<b>13,562</b>
Property, plant and equipment, net	15,570	3,842	2,373
Intangible assets	3,738	2,678	14
Goodwill	9,762	10,288	–
Deferred taxes	522	405	276
Other assets	12,911	–	–
<b>TOTAL ASSETS</b>	<b>90,864</b>	<b>31,920</b>	<b>16,225</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Financial liabilities	56	3,489	5,415
Accounts payable	15,289	4,766	4,194
Income taxes payable	3,195	1,400	4
Deferred taxes	604	–	–
Other current liabilities	2,534	2,109	2,204
<b>Current liabilities</b>	<b>21,678</b>	<b>11,764</b>	<b>11,817</b>
Deferred taxes	575	–	–
Cumulative redeemable preference shares	–	17,120	–
<b>TOTAL LIABILITIES</b>	<b>22,253</b>	<b>28,884</b>	<b>11,817</b>
Ordinary shares	6,418	5,267	1,454
Additional paid-in capital	63,475	5,267	1,420
Retained earnings (deficit)	(2,315)	(7,969)	788
Accumulated other comprehensive income	1,194	471	746
Employee stock purchase plan shares	(161)	–	–
<b>Shareholders' equity</b>	<b>68,611</b>	<b>3,036</b>	<b>4,408</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>90,864</b>	<b>31,920</b>	<b>16,225</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

All 1998 and 1997 balances have been restated from Deutsche Mark into Euro using the exchange rate as of January 1, 1999.

# Consolidated Statements of Cash Flows

(In thousands of €)	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Cash flows from operating activities:				
Net income (loss)	6,680	(6,990)	214	1,023
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation of property, plant and equipment	2,548	1,368	219	1,152
Amortization of goodwill and intangible assets	1,237	802	3	15
Acquired in-process research and development	–	9,300	–	–
Change in deferred taxes	1,135	543	(44)	1,078
Changes in current assets and liabilities:				
Accounts receivable	(14,065)	(2,637)	3,048	(3,571)
Inventories	(6,523)	(791)	(428)	44
Accounts payable	10,445	351	525	623
Other assets and liabilities	(2,364)	1,835	(194)	885
<b>Cash provided by (used for) operating activities</b>	<b>(907)</b>	<b>3,781</b>	<b>3,343</b>	<b>1,249</b>
Cash flows from investing activities:				
Purchases of property, plant and equipment	(14,487)	(2,861)	(412)	(981)
Purchases of intangible assets	(1,372)	(313)	(32)	(7)
Changes in other assets	(12,905)	–	–	–
Payments for the acquisition of business	–	(28,047)	–	–
<b>Cash used for investing activities</b>	<b>(28,764)</b>	<b>(31,221)</b>	<b>(444)</b>	<b>(988)</b>
Cash flows from financing activities:				
Changes in financial liabilities	(3,434)	386	(1,622)	82
Additions to short-term borrowings	12,190	3,489	–	–
Repayment of short-term borrowings	(12,190)	(3,809)	–	–
Proceeds (repayments) of redeemable preference shares including accrued dividends	(19,563)	17,465	–	–
Proceeds from issuance of ordinary shares	59,152	10,534	–	–
Purchase of employee stock purchase plan shares	(185)	–	–	–
Sale of employee stock purchase plan shares	231	–	–	–
<b>Cash provided by (used for) financing activities</b>	<b>36,201</b>	<b>28,065</b>	<b>(1,622)</b>	<b>82</b>
Cash provided by operating, investing and financing activities	6,530	625	1,277	343
Effect of foreign exchange rate changes on cash and cash equivalents	1,769	(50)	1	132
Net increase in cash and cash equivalents	8,299	575	1,278	475
Cash and cash equivalents at beginning of period	2,958	2,383	1,105	630
<b>Cash and cash equivalents at end of period</b>	<b>11,257</b>	<b>2,958</b>	<b>2,383</b>	<b>1,105</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

All 1998 and 1997 balances have been restated from Deutsche Mark into Euro using the exchange rate as of January 1, 1999.



## Consolidated Statements of Changes in Shareholders' Equity

(In thousands of €)	Predecessor				Total
	Ordinary shares	Additional paid-in capital	Retained earnings (deficit)	Accumulated other comprehensive income (loss) – currency translation adjustment	
<b>Balance at January 1, 1997</b>	<b>1,454</b>	<b>1,420</b>	<b>(235)</b>	<b>270</b>	<b>2,909</b>
Net income	–	–	1,023	–	1,023
Other comprehensive income	–	–	–	476	476
Total comprehensive income	–	–	1,023	476	1,499
<b>Balance at December 31, 1997</b>	<b>1,454</b>	<b>1,420</b>	<b>788</b>	<b>746</b>	<b>4,408</b>
Net income	–	–	214	–	214
Other comprehensive loss	–	–	–	(4)	(4)
Total comprehensive income (loss)	–	–	214	(4)	210
<b>Balance at February 28, 1998</b>	<b>1,454</b>	<b>1,420</b>	<b>1,002</b>	<b>742</b>	<b>4,618</b>

	Successor					Total
	Ordinary shares	Additional paid-in capital	Retained earnings (deficit)	Accumulated other comprehensive income (loss) – currency translation adjustment	Employee stock purchase plan shares	
New issuance of shares	5,267	5,267	–	–	–	10,534
Net loss	–	–	(6,990)	–	–	(6,990)
Other comprehensive income	–	–	–	471	–	471
Total comprehensive income (loss)	–	–	(6,990)	471	–	(6,519)
Accrued dividend – cumulative redeemable preference shares	–	–	(979)	–	–	(979)
<b>Balance at December 31, 1998</b>	<b>5,267</b>	<b>5,267</b>	<b>(7,969)</b>	<b>471</b>	<b>–</b>	<b>3,036</b>
New issuance of shares	1,151	58,001	–	–	–	59,152
Net income	–	–	6,680	–	–	6,680
Other comprehensive income	–	–	–	723	–	723
Total comprehensive income	–	–	6,680	723	–	7,403
Purchase of employee stock purchase plan shares	–	–	–	–	(185)	(185)
Sale of employee stock purchase plan shares	–	207	–	–	24	231
Accrued dividend - cumulative redeemable preference shares	–	–	(1,026)	–	–	(1,026)
<b>Balance at December 31, 1999</b>	<b>6,418</b>	<b>63,475</b>	<b>(2,315)</b>	<b>1,194</b>	<b>(161)</b>	<b>68,611</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

All 1998 and 1997 balances have been restated from Deutsche Mark into Euro using the exchange rate as of January 1, 1999.

# Notes to the Audited Consolidated Financial Statements

(In thousands of €, unless otherwise stated)

## 1. Basis of Presentation and Acquisition.

Dialog Semiconductor Plc (“Dialog” or the “Company”) is a leading supplier of mixed signal Application Specific Integrated Circuits (“ASICs”) to the wireless communications, automotive and industrial markets. The Company designs and develops analog and digital semiconductor chips specifically to suit the needs of its customers. Once developed the Company contracts with manufacturers for production of the chips.

The Company was formed in March 1998 to effect the acquisition of the Dialogue Semiconductor Limited Group from Daimler-Benz AG (now DaimlerChrysler AG). Dialog was majority-owned by the venture capital company, Apax Partners (“Apax”), and its related investors prior to the Company’s initial public offering in October 1999. In connection with its formation the Company’s shareholders contributed cash in exchange for ordinary shares with a par value of € 5,267, additional paid-in capital of € 5,267 and cumulative redeemable preference shares of € 17,465. Thereafter, the Company acquired the Dialogue Semiconductor activities from Daimler-Benz AG for € 28,047 in cash.

The Company has accounted for the acquisition using the purchase method of accounting. Accordingly, the costs of the acquisition were allocated to the assets acquired and liabilities assumed based upon their respective fair values. Amounts allocated to acquired in-process technology have been expensed at the time of acquisition. The excess of the cost of the acquisition over the fair value of the net assets acquired of approximately € 11,121 is being amortized over 15 years. The results of operations and cash flows of Dialogue have been consolidated with those of the Company from the date of the acquisition.

To determine the fair market value of the acquired in-process technology, the Company considered the income approach, whereupon fair market value is a function of the future revenues expected to be generated by an asset, net of all allocable expenses and charges for the use of contributory assets. The future net revenue stream is discounted to present value based upon the specific level of risk associated with achieving the forecasted asset earnings. The income approach focuses on the income producing capability of the acquired assets and best represents the present value of the future economic benefits expected to be derived from these assets.

The Company determined that the acquired in-process technologies had not reached technological feasibility based on the status of design and development activities that required further refinement and testing. The development activities required to complete the acquired in-process technologies included completion of ASICs designs, testing and validation, quality assurance, and customer prototype testing.

The acquired in-process technologies represent unique product related developments, the application of which is technically and legally limited to the unique company-customer relationship. Accordingly, these acquired technologies have no alternative future use other than the use for which the technologies were designed.

The following summary presents information concerning the purchase price allocation for the acquisition accounted for under the purchase method in March 1998.

	Net assets	In-process research and development	Goodwill	Other intangible assets	Purchase price
Dialogue Semiconductors	5,051	9,300	11,121	2,575	28,047

In the accompanying consolidated financial statements the terms "Dialog" or the "Company" when used in situations pertaining to periods prior to March 1, 1998 refer to the consolidated group of Dialogue Semiconductor activities of Daimler-Benz AG acquired by Dialog Semiconductor Plc and when used in situations pertaining to periods subsequent to March 1, 1998 refer to Dialog Semiconductor Plc and its consolidated subsidiaries. The consolidated financial information of the business acquired from Daimler-Benz AG is referred to herein as "Predecessor", while the consolidated financial information of the Company subsequent to the date of acquisition is referred to herein as "Successor". Because of the purchase price allocation, the accompanying financial statements of Successor are not directly comparable to those of Predecessor.

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP"). Dialog has previously prepared and reported its consolidated financial statements in the Deutsche Mark ("DM"). With the introduction of the Euro ("€") on January 1, 1999, Dialog has elected to present the accompanying consolidated financial statements in Euro. Accordingly, the Deutsche Mark consolidated financial statements for each period presented have been restated into Euro using the Deutsche Mark/Euro exchange rate as of January 1, 1999 of € 1 = DM 1.95583. Dialog's restated Euro financial statements depict the same trends as would have been presented if it had continued to present its consolidated financial statements in the Deutsche Mark. The Company's consolidated financial statements will, however, not be comparable to the Euro financial statements of other companies that previously reported their financial information in a currency other than the Deutsche Mark. All amounts herein are shown in thousands of Euro.

Certain prior year balances have been reclassified to conform with current year presentation.

## 2. Summary of Significant Accounting Policies.

**Principles of Consolidation** – The consolidated financial statements include all of the entities of the Company. Investments in which the Company has less than a 20% ownership are accounted for using the cost method. All intercompany accounts and transactions are eliminated in consolidation. As of December 31, 1999, Dialog had the following wholly-owned subsidiaries:

Dialog Semiconductor GmbH, Kirchheim/Teck-Nabern, Germany  
 Dialog Semiconductor (UK) Limited, Swindon, United Kingdom  
 Dialogue Semiconductors Limited, Swindon, United Kingdom  
 Dialog Semiconductor, Inc., Delaware, USA

**Cash and Cash Equivalents** – Cash and cash equivalents include highly liquid investments with original maturity dates of three months or less. Prior to the acquisition, the Company's cash and cash equivalents were invested through the central cash management function of Daimler-Benz AG.

**Inventories** – Inventories are valued at the lower of cost or realisable market value. Cost, which includes direct materials, labour and overhead plus indirect overhead, is determined using the first-in, first-out (FIFO) or weighted average cost methods.

**Other current Assets** – Other current assets at December 31, 1999 principally represent tax refunds receivable.

**Property, Plant and Equipment** – Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is charged on a straight-line basis over the estimated useful lives of the assets as follows:

Machinery and equipment	3 to 5 years
Leasehold improvements	Shorter of useful life or lease term

**Leasing** – The Company is a lessee of design software and property, plant and equipment which are accounted for as operating leases.

**Intangible Assets** – Purchased software and licenses are stated at cost and depreciated using the straight-line method over the estimated useful lives of three to five years. Intangible assets resulting from the acquisition include customer lists, patents, trade names and an assembled workforce and are amortized over their useful lives ranging from 9 to 18 years.

**Goodwill** – The excess of purchase price over the fair value of net assets acquired (goodwill) is amortized on a straight-line basis over 15 years, this being the expected period to be benefited. The Company assesses the recoverability of such amount by determining whether the amortization of the balance over its remaining life can be recovered from the undiscounted future operating cash flows of the acquired operation. The amount of impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds. The assessment of the recoverability of the excess of cost over net assets acquired will be impacted if estimated future operating cash flows are not achieved.

**Accounting for Long-Lived Assets** – The Company assesses impairment of long-lived assets and certain identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No impairment losses have been recognized in the years presented.

**Foreign Currencies** – The functional currency for the Company's operations is generally the applicable local currency. Accordingly, the assets and liabilities of companies whose functional currency is other than the Euro are included in the consolidation by translating the assets and liabilities into the reporting currency at the exchange rates applicable at the end of the reporting year. Equity accounts are translated at historical rates. The statements of income and cash flow of such non-Euro functional currency operations are translated at the average exchange rates during the year. Translation gains or losses are accumulated as a separate component of shareholders' equity. Currency transaction gains or losses arising from transactions of Dialog companies in currencies other than the functional currency are included in operations at each reporting period.

The exchange rates of the more important currencies against the Euro used in preparation of the consolidated financial statements were as follows:

Currency	Exchange rate at December 31,			Annual average exchange rate		
	1999 €	1998 €	1997 €	1999 €	1998 €	1997 €
Great Britain 1 GBP	1.61	1.43	1.52	1.52	1.49	1.45
United States 1 USD	1.00	0.85	0.92	0.94	0.90	0.88

**Revenue Recognition** – Revenue is recognized when title passes, generally upon shipment of products to customers, or services are rendered net of discounts.

**Product-Related Expenses** – Expenditures for advertising and sales promotion and for other sales-related expenses are charged to expense as incurred. Provisions for estimated costs related to product warranty are made at the time the related sale is recorded.

**Research and Development** – Research and development costs are expensed as incurred. Research and development costs which are charged to customers and, accordingly, are included in cost of sales, amounted to approximately € 1,492, € 310, € 1,926, and € 3,127 for the year ended December 31, 1999, for the period from January 1, 1998 to February 28, 1998, for the period from March 1, 1998 to December 31, 1998, and for the year ended December 31, 1997, respectively.

**Income Taxes** – Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company records deferred tax valuation allowances, if any, to reduce the deferred tax assets to amounts which will more likely than not be realized.

**Fair Value of Financial Instruments** – The carrying amount of cash and cash equivalents, accounts receivable, other current assets and current liabilities approximates fair market value due to the short maturity of these financial instruments.

**Stock-Based Compensation** – The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (“APB”) Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for its stock option plan. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying shares exceeded the exercise price.

**Earnings Per Share** – Earnings per share has been computed using the weighted average number of outstanding ordinary shares during the Successor period. Because the Company reported a net loss for the period March 1, 1998 to December 31, 1998, only basic per share amounts have been presented. Had the Company reported net income for the period March 1, 1998 to December 31, 1998, the weighted average number of shares outstanding would have potentially been diluted by 538,855 stock options (not assuming the effects of applying the treasury stock method).

**Concentration of Credit Risk** – The Company’s revenue base is diversified by geographic region and by individual customer. The Company’s products are generally utilized in the mobile communications and automotive industries. During 1999, 1998 and 1997 two customers individually accounted for more than 10% of the Company’s revenues. Such customers accounted for 68% in 1999, 59% for the period January 1, 1998 to February 28, 1998, 56% for the period March 1, 1998 to December 31, 1998 and 57% in 1997 of total revenues. The Company performs ongoing credit evaluations of its customers’ financial condition and, generally, requires no collateral from its customers.

**Use of Estimates** – The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent amounts at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### 3. Income Taxes.

The provision for income taxes consists of the following:

	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Current taxes				
Germany	2,286	1,641	323	–
Foreign	1,149	246	12	–
Deferred taxes				
Germany	1,044	–	9	987
Foreign	91	543	(53)	91
	<b>4,570</b>	<b>2,430</b>	<b>291</b>	<b>1,078</b>



Although Dialog is a UK company, its principal operations are located in Germany and all of its operating subsidiaries are owned by the German company. Accordingly, the following information is based on German corporate tax law. German corporate tax law applies a split-rate imputation with regard to the taxation of the income of a corporation and its shareholders. In accordance with the tax law, retained corporate income is initially subject to a federal corporate tax of 40% in 1999 and 45% in 1998 and 1997 plus a solidarity surcharge of 5.5% in 1999 and 1998 and 7.5% in 1997 on federal corporate taxes payable. Including the impact of the surcharge, the federal corporate tax rate amounts to 42.2% in 1999, 47.475% in 1998 and 48.375% in 1997. Upon distribution of retained earnings to shareholders, the corporate income tax rate on the earnings is adjusted to 30%, plus a solidarity surcharge of 5.5% in 1999 and 1998 and 7.5% in 1997 on the distribution corporate tax, for a total of 31.65% in 1999 and 1998 and 32.25% in 1997, by means of a refund for taxes previously paid.

In 1999 the Company applied a distributed corporate income tax rate of 30% to the earnings of its German subsidiary for 1999 compared to the undistributed corporate income tax rate of 45% for 1998 as the Company plans to distribute such earnings to the parent company.

A reconciliation of income taxes determined using the German corporate tax rate of 31.65% for 1999, 47.475% for 1998 and 48.375% for 1997 plus the after federal tax benefit rate for trade taxes of 10.426% for 1999, 7.525% for 1998 and 7.625% for 1997 for a combined statutory rate of 42.07% for 1999, 55% for 1998 and 56% for 1997 is as follows:

	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Expected provision (benefit) for income taxes	4,733	(2,508)	278	1,176
Credit for dividend distribution	(177)	—	—	—
Foreign tax rate differential	(343)	(616)	28	(118)
Amortization of non-deductible goodwill and in-process research and development	295	5,530	—	—
Others	62	24	(15)	20
<b>Actual provision for income taxes</b>	<b>4,570</b>	<b>2,430</b>	<b>291</b>	<b>1,078</b>

Deferred income tax assets and liabilities are summarized as follows:

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Property, plant and equipment	145	236	250
Net operating loss and tax credit carryforwards	415	191	723
Other	–	22	18
<b>Deferred tax assets</b>	<b>560</b>	<b>449</b>	<b>991</b>
Property, plant and equipment	(575)	–	–
Accounts receivable	(427)	–	–
Accounts payable	(177)	–	–
<b>Deferred tax liabilities</b>	<b>(1,179)</b>	<b>–</b>	<b>–</b>
<b>Net deferred tax asset (liability)</b>	<b>(619)</b>	<b>449</b>	<b>991</b>

#### 4. Additional Cash Flow Information.

The following represents supplemental information with respect to cash flows:

	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Interest paid	280	212	40	263
Income taxes paid	1,860	812	14	–

#### 5. Inventories.

Inventories are comprised of the following:

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Raw materials	2,527	711	638
Work-in-process	6,896	913	1,361
Finished goods	596	1,872	489
	<b>10,019</b>	<b>3,496</b>	<b>2,488</b>

## 6. Property, Plant and Equipment and Other Assets.

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Test equipment	14,511	3,582	1,617
Office and other equipment	6,133	5,111	4,766
Leasehold improvements	1,178	149	42
Assets under construction	–	29	–
	21,822	8,871	6,425
Less: Accumulated depreciation	(6,252)	(5,029)	(4,052)
	15,570	3,842	2,373

Depreciation expense amounted to € 2,548, € 219, € 1,368 and € 1,152 for the year ended December 31, 1999, for the period from January 1, 1998 to February 28, 1998, for the period from March 1, 1998 to December 31, 1998 and for the year ended December 31, 1997, respectively.

Included in other assets is a 19.47% cost basis investment (€ 1,974) in and a loan (€ 10,216) to ESM Holdings Limited, the parent company of ESM, a silicon wafer foundry in Newport, Wales and a supplier of the Company, totalling € 12,190 million. The loan bears interest at 5% per annum and is due in 2003 or immediately in the event of an initial public offering by ESM or a change in control. At December 31, 1999, the carrying value of the ESM loan approximated market value.

## 7. Financial Liabilities.

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Short-term borrowings	56	3,489	–
Liabilities to affiliated companies <sup>1)</sup>	–	–	5,415
	56	3,489	5,415

<sup>1)</sup> In 1997, represents borrowings from the central cash management function of Daimler-Benz AG.

At December 31, 1999, short-term borrowings represent amounts used under one of the Company's short-term lines of credit. These borrowings primarily bear interest at the lower of EURIBOR + 0.75% or 6.0% per annum and have no specified maturity date. At December 31, 1999, the Company had remaining unused short-term credit lines of € 13,104.

## 8. Other Current Liabilities.

Other current liabilities are comprised of the following:

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Accrued personnel and social costs	993	911	373
Accrued warranty	812	299	56
Outstanding invoices	254	377	873
Sales commissions	32	104	569
Other	443	418	333
	2,534	2,109	2,204

## 9. Cumulative Redeemable Preference Shares.

In October 1999, Dialog repaid the carrying amount, including cumulative unpaid dividends, of 5,640,194 shares of cumulative redeemable preference shares with a par value of £ 1 per share, issued at a premium of £ 1 per share. The carrying amount of redeemable preference shares had been increased by € 2,005 through a charge to retained earnings in 1998 and 1999 resulting in a total repayment of € 19,563.

## 10. Shareholders' Equity.

At December 31, 1999, Dialog had authorized 23,954,960 ordinary shares with a par value of £ 0.20 per share. Issued and outstanding were 21,034,465 ordinary shares.

On August 18, 1999, Dialog was re-registered as a public limited company under the laws of England and Wales and changed its name to Dialog Semiconductor Plc. Prior to that date, Dialog was incorporated as a private limited liability company, registered in England and Wales.

On September 24, 1999, Dialog approved a five-for-one split of the Company's ordinary shares and effected changes in its capital structure. In connection with the changes in capital structure, the authorized number of ordinary shares of the Company was increased by 4,750,000 shares. The Company also amended its Articles to allow for only one class of ordinary shares and one class of preference shares. All previously outstanding "A" and "B" ordinary shares have been converted into an equal number of the Company's ordinary shares with a par value of £ 0.20 per share (after adjustment for the five-for-one split). Each ordinary share entitles the holder to one vote. All share and per share amounts presented for periods after March 1, 1998 have been retroactively adjusted to give effect to the share split and the changes in capital structure.

On October 13, 1999, the Company completed an initial public offering of ordinary shares, receiving net proceeds (after deduction of underwriting discounts, stamp duty and other offering expenses) of € 59,152 from the sale of 3,750,000 new shares.

## 11. Employee Stock Purchase Plan.

On March 26, 1998, the Company and its then majority owner, Apax, adopted the Subscription and Shareholders Agreement under which employees and directors are invited from time-to-time, at the discretion of the Board, to purchase up to 1,728,445 ordinary shares of the Company from Apax or an established Employee Benefit Trust. The purchase price of the shares is equal to their estimated fair value on the date the employee or director subscribes for those shares. Employees and directors are immediately vested in their purchased shares. During the first quarter of 1999, the trust acquired 334,400 of ordinary shares from Apax Partners for purposes of distributing them to employees under the Employee Stock Purchase Plan. For the year ended December 31, 1999 and 1998, employees and directors purchased 236,740 and 1,290,680 ordinary shares, respectively, at fair value on the date of purchase.

## 12. Stock Option Plan.

On August 7, 1998, the Company adopted a stock option plan ("Plan") under which employees and directors may be granted from time-to-time, at the discretion of the Board, stock options to acquire up to 1,920,495 shares of the Company's authorized but unissued ordinary shares. Stock options are granted with an exercise price not less than the estimated fair value at the date of grant. Stock options have terms of ten years and vest over periods of one to five years from the date of grant.

The fair value of the stock option grants is estimated using the Minimum Value Method, with the following weighted-average assumptions used for stock options grants in 1999 and 1998, respectively: weighted average option price, which equals the fair market value at date of grant, of £ 1.18 and £ 0.40; a risk free interest rate of 4.0% for both years; and an expected life of five years for both years.

Stock option plan activity for 1999 and 1998 was as follows:

prices in £	1999		1998	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	538,855	0.40	—	—
Granted	386,570	1.18	538,855	0.40
Exercised	—	—	—	—
Forfeited	(5,175)	0.40	—	—
<b>Outstanding at end of year</b>	<b>920,250</b>	<b>0.73</b>	<b>538,855</b>	<b>0.40</b>
Options exercisable at year end	—	—	—	—

Weighted-average fair value of options granted during the year was £ 0.20 and £ 0.07 for 1999 and 1998, respectively.

The Company applies APB Opinion 25 in accounting for the Plan and, accordingly, no compensation cost has been recognized for its stock options in the consolidated financial statements. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS 123, *Accounting for Stock-Based Compensation*, the Company's net income (loss) would not have been materially different for 1999 and the period from March 1, 1998 to December 31, 1998.

The following table summaries information about stock options outstanding at December 31, 1999:

Exercise prices	Options outstanding	
	Number outstanding at December 31,	Weighted-avg. remaining contractual life
	1999	
£ 0.40	533,680	8.8
£ 0.80	69,755	9.3
£ 1.20	269,940	9.6
£ 1.60	46,875	9.6
£ 0.40 – £ 1.60	920,250	9.1

### 13. Commitments.

The Company leases design software, certain of its office facilities, office and test equipment, and vehicles under operating leases. Total rentals under operating leases, charged as an expense in the statement of income, amounted € 2,528, € 167, € 1,020 and € 801 for the year ended December 31, 1999, for the period from January 1, 1998 to February 28, 1998, for the period from March 1, 1998 to December 31, 1998 and for the year ended December 31, 1997, respectively. Future minimum lease payments under rental and lease agreements which have initial or remaining terms in excess of one year at December 31, 1999 are as follows:

	2000	2001	2002	2003	2004	Thereafter
Operating leases	4,469	3,572	2,010	753	238	985

The Company contracted in 1999 to acquire the rights to a 16 bit microprocessor core. Transfer of ownership of this technology will take place in several steps through the end of 2000. Licenses fees due in 2000 amount to € 2,483, thereof € 497 as a prepayment for license fees on a per unit sold basis.

In addition, the Company ordered ten test systems in the amount of € 17,500 to be installed during 2000 if the Company does not cancel prior to 90 days from the scheduled delivery date. Delivery time for these test systems is approximately 8 months.



#### 14. Segment Reporting.

The Company operates in one segment, the design and development of semiconductor chips.

	Successor	
	Year ended December 31,	For the period March 1, 1998 to December 31,
	1999	1998
Revenues:		
Wireless communication	68,052	28,648
Automotive	6,980	1,528
Industrial	7,852	4,584
Other	4,362	3,438
	<b>87,246</b>	<b>38,197</b>

Revenues are allocated to countries based on the location of the customer; long-term assets are allocated according to the location of the respective units.

	Successor		Predecessor	
	Year ended December 31,	For the period March 1, 1998 to December 31,	For the period January 1, 1998 to February 28,	Year ended December 31,
	1999	1998	1998	1997
Revenues:				
Germany	21,024	11,550	2,116	11,331
Sweden	29,679	9,835	1,498	13,169
Other European countries	24,873	9,673	1,453	8,755
USA	5,076	4,730	699	4,547
Asia	5,641	2,100	515	660
Other countries	953	309	—	66
	<b>87,246</b>	<b>38,197</b>	<b>6,281</b>	<b>38,528</b>

	Successor		Predecessor
	December 31,		
	1999	1998	1997
Long-term assets:			
Germany	36,079	11,473	1,495
United Kingdom	5,457	5,161	1,168
USA	967	579	—
	<b>42,503</b>	<b>17,213</b>	<b>2,663</b>

## 15. Related Party Transactions.

Adtran Inc. ("Adtran") and Ericsson Radio System AB ("Ericsson") each hold a substantial ownership interest in the Company. The Company sells components to Adtran and Ericsson in the ordinary course of business. The selling price for these transactions are negotiated on an arm's length basis. Revenues amounted to € 48,502 for the year ended December 31, 1999, € 2,740 for the period January 1, 1998 to February 28, 1998, € 18,131 for the period March 1, 1998 to December 31, 1998 and € 20,859 for the year ended December 31, 1997. Net receivables due from Adtran and Ericsson were € 12,645, € 4,424 and € 5,346 at December 31, 1999, 1998 and 1997, respectively.

In August 1999, the Company acquired a 19.47% interest in ESM Holdings Limited, the parent company of ESM, a silicon wafer foundry in Newport, Wales and a supplier of the Company. Included in cost of sales in 1999 are purchases of silicon wafers from ESM in the amount of € 25,764, payables due to ESM were € 1,961 at December 31, 1999.

Prior to March 1, 1998, the Predecessor Business was a majority-owned subsidiary of Daimler-Benz AG. For the year ended December 31, 1997, the Predecessor Business had revenues of € 3,489 with other Daimler-Benz AG subsidiaries. The Predecessor Business also used the Daimler-Benz AG salesforce to sell its products. Total selling expenses charged by Daimler-Benz AG to the Predecessor Business amounted to € 2,252 for the year ended December 31, 1997.

## 16. Earnings Per Share.

Earnings per share is determined as follows (in thousands of Euro, except number of shares and earnings per share):

	Successor	
	Year ended December 31,	For the period March 1, 1998 to December 31,
	1999	1998
Net income (loss)	6,680	(6,990)
Less preference share dividend	(1,026)	(979)
Net income (loss) applicable to ordinary shareholders	5,654	(7,969)
Weighted average number of shares outstanding (in thousands) – basic	17,990	17,284
Dilutive effect of stock options	905	-
Weighted average number of shares outstanding (in thousands) – diluted	18,895	17,284
Earnings (loss) per share – basic	0.31	(0.46)
Earnings (loss) per share – diluted	0.30	(0.46)

# Board of Directors

## Report of the Board of Directors

The Board oversaw the functioning of executive management of the Company and at the quarterly Board Meetings of 22nd February 1999, 7th May 1999, 29th July 1999 and 4th November 1999 assured itself of the proper conduct of executive management during the year 1999. At such Board Meetings the Board received and analysed reports from the Chief Executive as to the achievements of the Company against financial budgets and the progress made in meeting commercial aims for the year.

Guidance was also given by the Board to the Chief Executive both in relation to business concerns and business opportunities. Action items were authorized which were reported on and reviewed as to achievement at the following Board Meeting.

The Board initiated a more focused strategy for key issues such as collaboration with customers, Company management, wafer supply, design capacity and technology roadmaps.

In addition to the quarterly Board Meetings additional Board Meetings, were convened in connection with the Company's listing on the Frankfurt Neuer Markt and EASDAQ. The Board, in accordance with the Company's Articles of Association, on various occasions appointed Committees of the Board to decide upon various technical matters related to the initial public offering.

The Board Meeting of 4th November 1999 resolved to appoint a Remuneration Committee and Audit Committee and the respective terms of reference were approved at the Board Meeting of 10th February 2000.

The Remuneration Committee comprises Jan Tufvesson, Michael Glover and Tim Anderson. The Audit Committee comprises Jan Tufvesson and Michael Glover. The Committees both met for the first time on 8th February 2000.

The annual financial statements for the year ended 31st December 1999 were audited and given an unqualified auditors' opinion by KPMG, the Company's independent auditor, appointed by the shareholders at the annual general meeting of the shareholders of 2nd August 1999.

The Board has reviewed and approved the annual financial statements and no objections have been raised.

Notwithstanding the considerable effort of the executive management of the Company to secure the Company's listing on the Frankfurt Neuer Markt and EASDAQ the Company in 1999 was able to develop and consolidate its market position as one of the world's leading suppliers of Mixed Signal ASICs. For this achievement the Board extends its thanks to the executive management and the Company's employees.

London, March 2000

Jan Tufvesson, Chairman

# Members of the Board of Directors

## Jan Tufvesson (Chairman)

aged 61, joined the board of the Group's then holding company in 1990. He was elected chairman of the Board on March 26, 1998. Mr. Tufvesson graduated from the Royal University of Technology in Stockholm with a masters degree in electronic engineering in 1962. Between 1972 and 1980 he held a number of senior positions on the Royal Swedish Air Force Board. In 1980 he joined Ericsson where he held a number of senior positions at Ericsson, the last being a vice president at LM Ericsson corporate, responsible for all procurement in Ericsson and for developing relationships with key suppliers. In 1998, Mr. Tufvesson retired from Ericsson and is now Managing Director of Tuf InterAktive Leadership AB in Stockholm. Mr. Tufvesson's other directorships include Arc Cores Ltd and Svep Design Center AB.

## Roland Pudelko (Chief Executive and President)

aged 47, joined Dialog Semiconductor in 1989 as managing director. He has 22 years experience in electronics and microelectronics, primarily in management positions within the Daimler-Benz Group. During that time, he was a board member of a joint venture with the Taiwanese company ACER, and in the TEMIC Group he was responsible for the coordination of world-wide design and engineering. Mr. Pudelko has a diploma in communication technologies from the vocational college (Fachhochschule) of Esslingen. He is also the sole managing director of Dialog Semiconductor GmbH and the other consolidated subsidiaries of Dialog Semiconductor Plc. He is a member of the board of directors of ESM Holdings Limited, in which the Company holds a minority interest.

## Timothy Richard Black Anderson

aged 39, joined the board of the Group's then holding company in 1990. He has been a partner with the London law firm Reynolds Porter Chamberlain since 1989 and specializes in media and technology.

## Michael John Glover

aged 61, joined the board of the Group's then holding company in 1990. He was involved in the establishment and financing of the company's operations in the United Kingdom. He is an economics graduate of the University of Birmingham and is Managing Director of Aylestone Strategic Management Limited. Prior to becoming involved in private equity fund management in 1985 he was a senior executive with electronic companies in the United Kingdom, Europe, the Far East and North America. Mr. Glover's other directorships include Biocode Inc., Central Industries Limited, GADC Holdings Limited, JBS Industries Limited and Mercury Grosvenor Trust Plc.

#### John McMonigall

aged 56, was elected as a director of Dialog Semiconductor Plc on March 26, 1998. He joined Apax Partners as a director in 1990 and is currently the director responsible for investments in telecommunications, software and related fields. Between 1986 and 1990, Mr. McMonigall held a variety of senior positions in British Telecom, including managing director of the customer service division. He was also a member of the management board of British Telecom. He is currently on the board of seven other public and private portfolio companies, including HighwayOne, Neurodynamics, AutoNomy, Jazztel, TelDaFax AG and Crane Telecom.

#### Michael Risman

aged 31, joined the board of Dialog Semiconductor Plc in August 1999. He is an assistant director at Apax Partners where he is responsible for investments in information technology including electronics, software and e-commerce. Before joining Apax, Mr. Risman worked for The MAC Group as a strategy consultant and for Jaguar Cars as an engineer. He is a director of Streamserve Inc., and also represents Apax Partners on the boards of ARC Cores Ltd., Argonaut Software Ltd. and Practice Resource Systems Ltd. He obtained a MBA from Harvard Business School and a MA (Hons) in Electrical Engineering and Management from Cambridge University.

#### Mark C. Smith

aged 59, was elected as a director of Dialog Semiconductor Plc on March 26, 1998. Mr. Smith was co-founder, chairman of the board, president and chief executive officer of Universal Data Systems (a modem and data communications equipment manufacturer later purchased by Motorola, Inc.) from 1970 to 1979 and remained as its president until co-founding Adtran in 1985.

#### Tord Martin Wingren

aged 39, was elected as a director of Dialog Semiconductor Plc on March 26, 1998. Mr. Wingren has worked for Ericsson for more than 15 years. Since April 1999, he has been director & general manager strategic PU UMTS & Research. This unit has responsibility for inventing, developing, manufacturing, marketing and selling UMTS products.

The Articles currently provide that one-third (or a number nearest to one-third) of the Directors shall retire at every annual general meeting; but if any director has at the start of the annual general meeting been in office for more than three years since his last appointment or re-appointment, he shall retire. A Director who retires at an annual general meeting may, if willing to act, be re-appointed.

## Additional Information

### Facilities.

Dialog Semiconductor Plc and its wholly-owned subsidiaries currently lease the following properties:

Location	Approximate area (m(2))	Principal Use
Neue Strasse 95, Kirchheim/Teck-Nabern, Germany	2,586	Company headquarters, office operation for design, marketing and testing
Windmill Hill, Business Center, Swindon, Wiltshire, United Kingdom	780	Office operation for marketing and design
Mannheimer Strasse 1 Heidelberg, Germany	307	Office operation for design
54 Old Highway 22, Clinton, New Jersey USA	661, plus 119 of common area	Office operation for marketing and design
Industriestrasse 1 Munich/Germering, Germany	530	Office operation for design

### Principal Shareholders.

The following table sets forth specified information with respect to the beneficial ownership of (1) any person known by us to be the beneficial owner of more than 10% of our outstanding shares, (2) all of our directors and executive officers as a group.

Name and Address	Number	Percent
Apax Funds Nominees Limited	6,784,190	32.3
Adtran, Inc	2,652,905	12.6
Apax Germany II L.P.	2,261,395	10.7
Ericsson Radio Systems AB	1,167,530	5.6
Employees/Employee Benefit Trust	900,080	4.3
All directors and executive officers as a group (8 persons) (1)	828,365	3.9
Free float	6,440,000	30.6
Total	21,034,465	100.0

(1) Of the 828,365 shares held by the key management and members of our board of directors, Roland Pudenko holds 184,525 (0.88%), Richard Schmitz holds 92,210 (0.44%), Gary Duncan holds 92,210 (0.44%), Jeff Garriss holds 92,210 (0.44%), Peter Hall holds 92,210 (0.44%), Martin Klöble holds 75,000 (0.36%), Jan Tufvesson and his relatives hold 100,000 (0.48%) in aggregate and Michael John Glover and his relatives hold 100,000 (0.48%) in aggregate.

### Disclosure of Interests.

The UK Companies Act 1985 requires that if a person becomes directly or indirectly interested in 3% or more of any class of our issued shares that carry the right to vote at our general meetings, such person must notify us of this interest within two business days. After the 3% threshold is exceeded, such person must notify us in respect of increases or decreases of 1% or more.

### Legal Proceedings.

Neither we nor any of our consolidated subsidiaries are involved in litigation or arbitration proceedings that could have a substantial impact on our financial position or the financial position of any of our consolidated subsidiaries. We have not been involved in such litigation or arbitration proceedings in the past two years, nor, to the best of our knowledge, are such proceedings pending or threatened against us or any of our consolidated subsidiaries.

### Directors' and Executives' Compensation.

We pay non-employee directors who are not associated with any of our principal shareholders £ 5,000 to £ 15,000 per annum. None of the members of non-employee directors was our employee at any time during 1999. Timothy Anderson, a member of the Board, is also a partner in the law firm Reynolds Porter Chamberlain, which frequently acts as our legal adviser. Payments to Reynolds Porter Chamberlain for legal services rendered during the 1999 fiscal year amounted to approximately € 379,000.

We reimburse all of our directors for their reasonable travel expenses incurred in connection with attending meetings of the board of directors or committees thereof. Under certain circumstances, directors are also eligible to receive stock options. The following table sets out the aggregate amount of remuneration paid by us and our subsidiaries to all our directors and senior executives as a group for services rendered during the year ended December 31, 1999.

	Directors and Senior Executives
	(in €)
Base salary	787,400
Bonuses	397,998
Monetary value of other benefits	39,270
Amounts reserved for pension or similar benefits	0

Each of our vice-presidents has entered into a service agreement with us and our subsidiaries. The service agreements are all of unlimited duration. In the case of Gary Duncan and Peter Hall, their agreements are terminable by either party to the agreement on 6 months' written notice to the other. Jeff Garriss' agreement is terminable by either party on 180 days' written notice. Richard Schmitz's agreement is terminable by either party on 3 months' notice to the end of a calendar quarter. Martin Klöble's agreement is terminable subject to German statutory provisions for termination. None of the service agreements contain provisions subjecting us to onerous obligations in the case of early termination.





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