Infineon Technologies Annual Report 2005

Gaining momentum

Infineon at a glance

Infineon Technologies originated from the semiconductor division of the former parent company Siemens and was established as a public company, based in Munich, Germany, in April 1999. The Company has been listed on the Frankfurt and New York Stock Exchanges (NYSE) since March 13, 2000 with the ticker symbol "IFX". With a global presence, Infineon operates in the USA from San Jose, California, in Asia-Pacific from Singapore, and in Japan from Tokyo. With approximately 36,400 employees worldwide, Infineon achieved revenues of €6.76 billion in the 2005 financial year, compared to €7.19 billion in the 2004 financial year.

Segment	Applications
Automotive, Industrial and Multimarket (AIM) **For cars:** chips for drive control, safety, body convenience functions, and navigation **For industry:** chips to control electric drives and industrial facilities, power supply, energy transmission and conversion **For multimarket:** broad use in application areas such as household appliances, entertainment electronics, computers, and communications equipment **In chip cards:** chips with contact-based or contactless interface	**Automotive:** – Power train (engine and transmission control), car body and convenience electronics, safety (airbag, ABS, EPS), infotainment (navigation and telematics) **Industrial:** – Power packs and power supply units for electric drives and industrial facilities, welding equipment, wind turbines, trains, railroads, and medical technology **Multimarket:** – Power packs and power supply units for PCs, notebooks, television sets, DVD players, and electric motor drives for washing machines, ventilators, air conditioners, lamp control, hard drives, computer peripherals, and game consoles **Chip cards:** – A variety of applications for chip-based cards in the fields of communications (SIM, U-SIM cards, telephone cards), payment systems (credit and debit cards), identification (ID cards, insurance cards), entertainment (Pay-TV cards), object identification and logistics (RFID tags), platform security for computers and networks (TPM)
Communication (COM) **Wireline communications:** chips for conventional voice communications, access technologies for broadband, mobile phone infrastructure, and applications for end customers **Wireless communications:** chips and system solutions for mobile phones and mobile network infrastructure, cordless telephones, and wireless networks	**Wireline communications:** – Conventional voice communications – Copper-based broadband data communications – Integrated voice and data communications – Home networks **Wireless communications:** – Mobile communications, cellular base stations – Cordless telephones – Radio frequency technology for short, medium, and long-range distances – Television receivers – Navigation
Memory Products (MP) **DRAM memories:** for applications in the fields of electronic data processing, communications, and consumer electronics **Numerous specialty memories:** optimized for high transmission rates and low power consumption **Non-volatile memories:** for applications in the fields of mobile communications and consumer electronics	– **Data processing:** PCs, notebooks, workstations, servers – **Graphic applications:** graphics boards, game consoles – **Mobile applications:** PDAs, smart phones – **Consumer electronics:** digital cameras, MP3 players, set-top boxes, USB flash drives

1 Alphabetically.

Products	Market position	Key customers[1]	Competitors[1]
Automotive: --- Microcontrollers, power semiconductors, sensors (tire pressure, temperature, inertia, magnetic field sensors), components for in-car vehicle busses (CAN, LIN, MOST) **Industrial:** --- Microcontrollers, power semiconductor ICs, discrete power semiconductors, IGBT and bipolar modules, discrete small-signal semiconductors **Multimarket:** --- Thyristors and diodes, sensors, high-frequency semiconductors, discrete semiconductors, plug-in memory modules, security chips, power semiconductors **Chip cards:** --- Contact-based and contactless security controllers (8-bit, 16-bit, 32-bit) and memory, security memory, Trusted Platform Modules (TPM), RFID chips	**Automotive:** --- **No. 2** in automotive semiconductors (**No. 1** in Europe) --- **Leader** in tire pressure monitoring systems **Industrial, Multimarket:** --- **No. 1** in power semiconductors --- **No. 2** in semiconductors for industrial drives and traction --- **No. 4** for all industrial applications **Chip cards:** --- **No. 1** in chip card ICs	**Automotive, Industrial, and Multimarket:** --- **A**BB, Asustec, Autoliv, Avnet --- **B**osch --- **C**ontinental Automotive Systems --- **D**elphi, Delta, Denso --- **F**oxconn --- **G**igabyte --- **H**ella, Hitachi --- **I**CS --- **L**ear --- **M**icrosoft, Motorola ACES, MSI --- **R**ockwell --- **S**AC, Siemens --- **T**RW --- **V**isteon **Chip cards:** --- **A**xalto --- **G**emplus, Giesecke & Devrient --- **O**berthur Card Systems	**Automotive, Industrial, and Multimarket:** --- **F**airchild, Freescale --- **I**nternational Rectifier --- **M**itsubishi --- **N**ational Semiconductor --- **O**N Semiconductor --- **P**hilips --- **R**enesas --- **S**TMicroelectronics --- **T**oshiba **Chip cards:** --- **A**tmel --- **P**hilips --- **R**enesas --- **S**amsung, STMicroelectronics
Wireless communications: --- Interface components for voice communications in switching centers and terminal units (CODECs, SLICs, ISDN, T/E etc.) --- Solutions for integrated voice and data communications, and VoIP --- System solutions for wireline broadband technologies (ADSL, ADSL2, ADSL2+, VDSL, VDSL2) --- System solutions for DSL modems, routers, home gateways, WLAN access points, NICs, etc. **Wireless communications:** --- Baseband processors and high-frequency transceivers for standard wireless communication standards (GSM, GPRS, E-GPRS, EDGE, W-CDMA, DECT, WDCT, Bluetooth) --- 1-chip solutions and modules, in which baseband processors and high-frequency transceivers are combined into a single component --- System solutions for mobile phones including platform design, operational software, applications --- Services for system integration and customized adaptations --- Analog and digital TV tuners for stationary and mobile TV receivers --- Power transistors for cellular base station amplifiers (up to 180 watts) for 2G through 3G, CDMA/2000 cellular standards --- GPS receivers --- BAW filters	**Wireline communications:** --- **No. 1** in ISDN --- **No. 1** in T/E carriers --- **No. 1** in analog line cards --- **No. 3** in access networks --- **No. 4** in digital line cards --- **No. 5** in application specific components **Wireless communications:** --- **No. 1** in high-frequency transceivers --- One of the top two suppliers for DECT/WDCT --- **No. 2** in power transistors for cellular base stations --- **No. 3** in application-specific components --- **No. 4** in Bluetooth	**A**lcatel **B**enQ **E**ricsson **H**uawei **L**G Electronics **M**atsushita, Motorola **N**okia **S**amsung, Siemens **Z**TE	--- **A**gere --- **B**roadcom --- **C**onexant --- **E**ricsson Mobile Platforms --- **F**reescale --- **I**ntel --- **P**hilips Semiconductors --- **Q**ualcomm --- **R**enesas Technology --- **S**TMicroelectronics --- **T**exas Instruments
--- Standard DRAM memory with memory densities from 64 Mbit to 1 Gbit --- Memory modules for PCs, notebooks, subnotebooks, workstations, and servers with memory densities from 64 MByte to 8 GByte --- Specialty memories for graphics applications (Graphics RAM) --- Specialty memories for mobile systems (Mobile-RAM, Cellular RAM) --- Non-volatile memory (NAND-Flash) --- Flash memory cards with memory densities from 64 MByte to 256 MByte for standard formats: SD-Card, MMC, and USB flash drives	--- **No. 4** in DRAM memory --- **Technological leader** in 300-millimeter wafer production --- **Top position** in high-performance graphics memories --- **Top position** in power-saving specialty memories --- **Top position** in highly complex memory modules for workstations and servers	-- **A**cer, Asustek, ATI -- **C**isco -- **D**ell -- **E**MC -- **F**ujitsu-Siemens -- **H**P, HTC -- **I**BM -- **K**ingston -- **L**enovo, Lexar Media, LG Electronics -- **M**icrosoft, Motorola -- **N**EC, Nvidia -- **S**ony, Sun Microsystems	**E**lpida **H**ynix **M**icron **N**anya **P**owerChip **S**amsung

--- Our Company, from p. 14

Infineon key data as of and for the financial year, ended September 30[1]

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

1 Columns may not add due to rounding.
2 Free cash flow = Net cash provided by operating activities minus net cash used in investing activities adjusted by purchases (proceeds from sales) of marketable securities available for sale.
3 Gross cash position = Cash and cash equivalents plus marketable securities.
4 Net cash position = Gross cash position minus short and long-term debt.
5 Return on equity = Net income (loss) divided by average shareholders' equity employed.
6 Return on total assets = Net income (loss) divided by average total assets.
7 Equity-to-fixed-asset ratio = Total shareholders' equity divided by fixed assets.
8 Debt-to-equity ratio = Long-term and short-term debt divided by average shareholders' equity.

Basic share information

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

Forward-looking statements
This annual report contains forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates, and projections, and you should not place too much reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any of them in the light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement.

Setting the pace.

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

Title

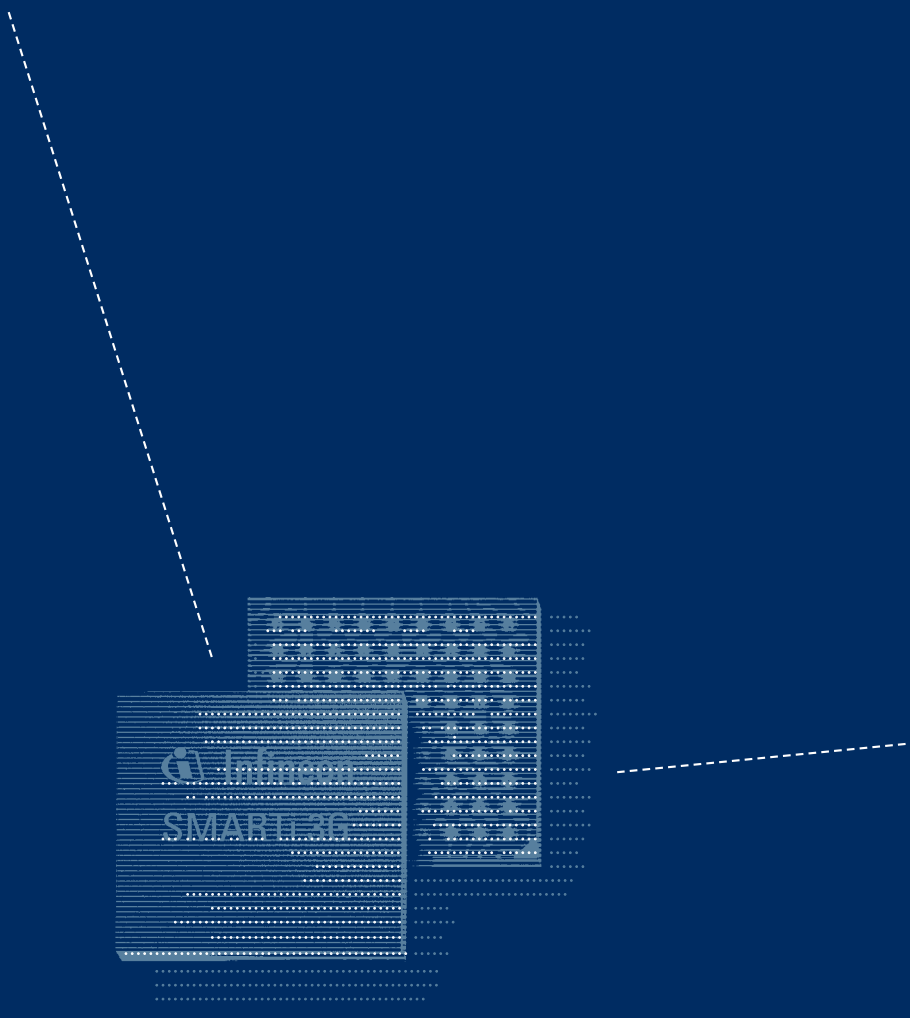
In future, not only voice and data but also entire films and sports events will be transmitted at the same time through telephone lines. VDSL2, the latest broadband technology, makes this possible. We are a market leader in this field with our VINAX chip.

Gaining momentum.

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

SMARTi 3G

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



Shareholder information

Letter to the shareholders

Dr. Wolfgang Ziebart
President and CEO of Infineon Technologies AG

Ladies and Gentlemen,

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

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

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

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

In two significant businesses we identified the potential for profitable future development. Both these businesses, namely, base-band processors for mobile phones and security and chip card ICs, are currently implementing a clearly defined restructuring plan. In the case of base-band processors, we have developed an aggressive and systematic plan designed to help us gain new customers. It is based on the further development of our world-leading radio frequency technology as well as on new processors for mobile phones. These technologies will be complemented by UMTS/EDGE/GSM-protocol software. We are thus in a position to offer the market an outstanding, highly competitive range of mobile phone platforms scaleable from the low-tech entry segment to the high-end. By these means, we should achieve significantly improved results by the end of the 2006 financial year. Following enormous efforts in cost saving and product development, one can foresee that the position in security and chip card ICs will also have improved significantly by the end of the 2006 calendar year. We will be focusing more strongly on products with higher added-value such as access technologies, payment and identification systems. Improving our profitability here has clear priority over maintaining our share of the world market, which is currently around 40 percent. We are confident that we will be successful in achieving our objective of profitable growth.

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

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

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

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

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

I hope that I could convey to you through this brief exposition how we have been addressing with truly significant issues for our company over the past months. Having strategically assessed our position thoroughly, we have decided to implement systematically the measures we identified. The future development of our company lies in our own hands. We must do everything we can to make 2006 a better year for us all, even if experts' forecasts for the semiconductor market once again presuppose single-digit growth.

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

Munich, November 2005

Yours sincerely

Dr. Wolfgang Ziebart
President and CEO

The Management Board of Infineon Technologies AG

From left:

Prof. Dr. Hermann Eul

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

Peter J. Fischl

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

Dr. Wolfgang Ziebart

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

Peter Bauer

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

Kin Wah Loh

Head of Memory Products segment
Chemical engineer (BSc); member of the Management Board since December 2004

The Infineon share

Infineon shares did not benefit from positive stock market trends

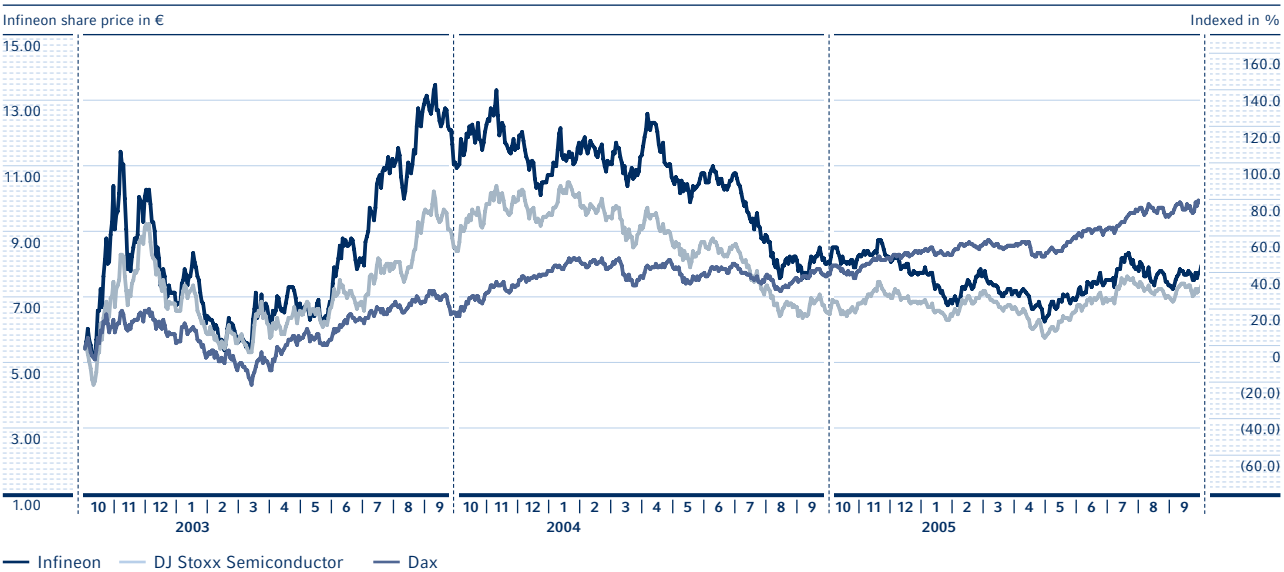
Infineon share price virtually unchanged over reporting year.
DJ Stoxx Semiconductor index up 13 percent in the 2005 financial year.
On average, 9.7 million Infineon shares traded daily in the past financial year.

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

Infineon was affected by this trend, but also faced considerable price pressure in the DRAM and chip card business, as well as a significant loss of market share by one of its most important customers in the mobile phone market. These factors contributed to make Infineon shares lag the semiconductor sector over the year. Infineon shares began the financial year in line with the market, reaching an annual high of €9.00 on November 18, 2004; then the share price began to decline, hitting a year low of €6.43 on April 29, 2005. In this period in particular, Infineon lost ground in comparison with other semiconductor shares. Thereafter, Infineon shares recovered along with the market and ended the reporting year at €8.18, compared with €8.22 a year before. The virtually unchanged share price did not improve the disappointing long-term trend; Infineon stock remained 77 percent lower than its IPO price on March 13, 2000. Relative to the DJ Stoxx Semiconductor index, however, Infineon stock declined by somewhat less over the period.

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

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



Infineon share statistics

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

Long-term performance of Infineon shares with indices in %

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

1 Based on issue price of €35/$33.92.

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

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

1 Undiluted.

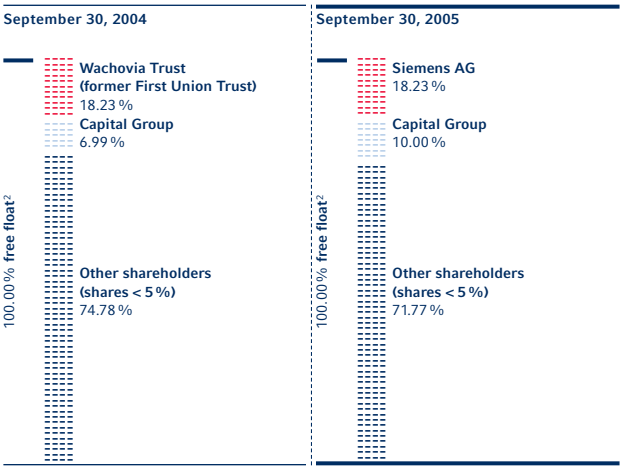
Infineon pays no dividend

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

Shareholder structure

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

Shareholder structure[1]



1 In accordance with companies' mandatory reporting, as known to Infineon.
2 Free float according to FTSE definition. Deutsche Börse and Stoxx do not include Siemens AG or Wachovia Trust shares in Infineon free float.

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

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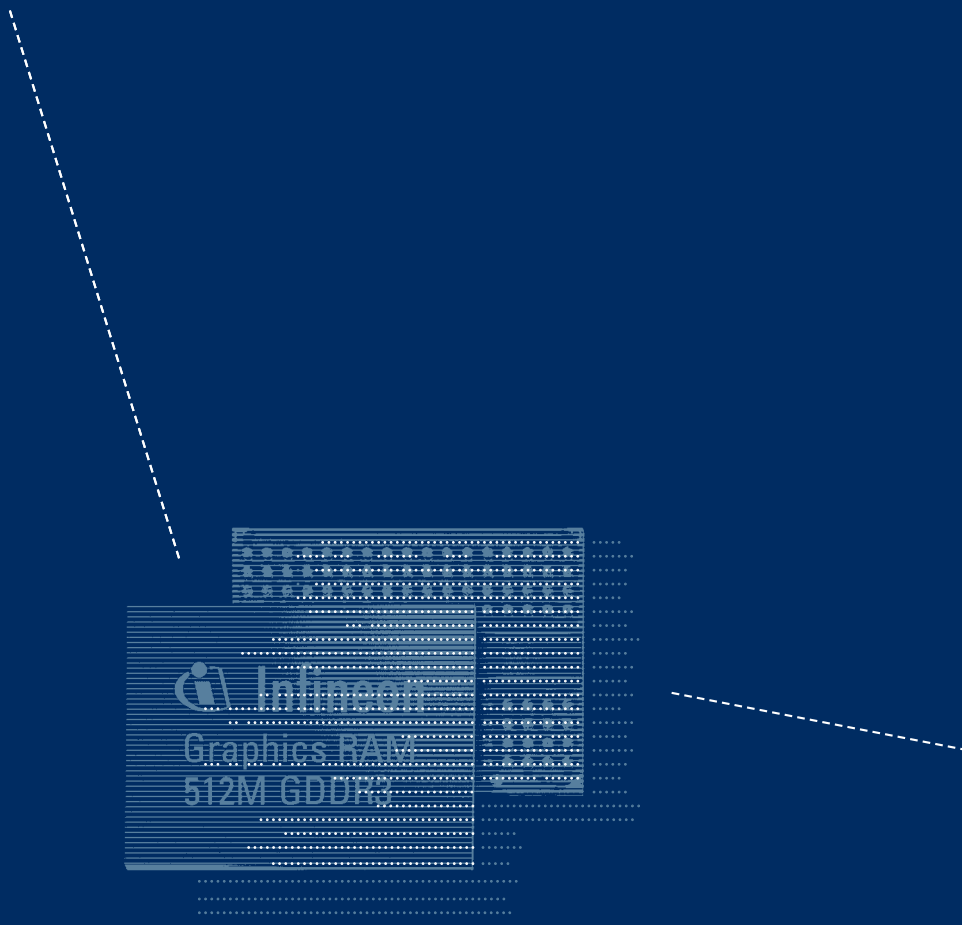
512M GDDR3

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



Our Company

Did you know that ...

- the recovery of brake energy is a way to save fuel that has hardly been exploited? This is now being employed in hybrid cars whose semiconductors are worth between $400 and $600, more than twice as much as those in gasoline-driven cars.

- U.S. law stipulates that all light vehicles must be equipped with tire-pressure monitoring sensors starting September 2007?

- if PCs had more efficient power supply units it would save the energy produced by four power plants in the U.S. alone?

- 20 billion kilowatt-hours are consumed in Germany each year just by equipment in stand-by mode? This costs some €2 billion, and corresponds to the output of two power plants.

- by 2005, more than 40 European and Asian states had decided to introduce an identification card with a security chip? This will affect over two billion people.

Cutting energy use, securing growth

The Asian economy is growing and so is its energy use. As the standard of living increases, cars, air conditioners, washing machines, and consumer electronics enter Asian households. Now this region, along with the rest of the world, is confronted with the difficult task of keeping its energy use as low as possible. But this can only be achieved by reducing the loss of energy through heat dissipation, caused by inefficient energy conversion of electric devices. This is where power semiconductors can contribute by enabling higher-efficiency power supply units.

Cars fascinate not least because of their mostly invisible electronics. Semiconductors are nowadays integrated in almost all elements of an automobile. New driver assistance systems process data from the road and surroundings of the vehicle, warn drivers of dangerous situations, or, in emergencies, even actively intervene in the driving of the car. Here, for example, sensors based on radar technology are used to identify objects near and far.

Sophisticated power train electronics based on Infineon components already contribute to lower fuel consumption today. With crude oil prices rising rapidly, energy-saving hybrid motor technology – combining internal combustion and electric motors – has attracted public attention. In such systems, depending upon the driving situation, power semiconductors either switch on the electric motor or charge a special high-voltage battery with any excess energy produced.

Whatever the impact of economic growth is on consumers' behavior, Infineon's products offer ways to save energy.

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

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

Automotive electronics: driven by fuel saving and passenger safety

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

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

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

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

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

Industrial electronics: demand higher efficiency and smaller components

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

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

Chip card: the highest of security requirements

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

SIM cards have also gained in importance, particularly through the immense growth of the mobile phone market in emerging countries. Low security standards for cards in those countries have, however, led to low barriers to

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

--- Letter to the shareholders, p. 4

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

ASIC & Design Solutions: customized chips include great system expertise

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

Sites expanded in Asia and Europe

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

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

--- Infineon's sites worldwide, p. 28

Infineon innovations

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

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

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

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

TPM 1.2
Delivery has begun of the second generation of TPM chips for PC and notebook manufacturers. Over time, we expect these chips also to be used for set-top boxes, game consoles, and mobile phones.

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

Did you know that ...

... Africa, with over 52 million mobile phone users, has been the world's fastest-growing mobile phone market during the past five years? In contrast, it has just 25 million wireline connections.

... every mobile phone in Japan will soon feature a navigation system?

... you can receive data a hundred times faster using the new VDSL2 standard than with a first-generation DSL connection?

... Korea is the first country in the world where mobile phone users receive digital television on their telephones and can catch the latest news, sports events, and music TV while in the subway, on the street, or in a café?

... the 2006 Soccer World Cup in Germany will see the exclusive use of Voice over IP telephony, with all 12 stadiums linked for voice and data transmission?

Mobile phone boom in emerging countries

Rarely have there been so many fundamental changes in communications technology as today – whether visible or not to the user, whether in wireline or wireless technology, whether in developed or emerging nations.

Take mobile phones. The most basic models have now reached a price level that makes them affordable to consumers in emerging countries, while the industry is working hard at reducing production costs even further. Affordable phones are attracting predominantly buyers in Africa, China, India, Russia, and South America, which constitute – and will remain – the fastest-growing segments of the mobile phone market. But the top-end applications are also springing to life, as UMTS gains momentum and started to attract wider use in 2005.

Take broadband access. While the first DSL connections were once seen as a more user-friendly way to surf the Web, the data connection via the traditional, ubiquitous telephone copper wire is slowly developing into an all-purpose medium. We make calls and also watch television through the very same data line. Media convergence of telephone, computer, and TV (triple-play) is the latest trend in the field.

Take digital television. Around the globe, a shift is underway from analog to digital television, driven by more efficient use of transmission channels. This holds true for terrestrial as well as for cable and satellite systems. And today, one can even watch television on mobile phones. Digital television receivers are a dynamic growth market.

Wherever people communicate – Infineon's chips very often make the crucial link work.

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Communication
Wireline and wireless communications converge

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

Movement in communication technology

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

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

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

--- People at Infineon, p. 33

VDSL2 is now seen as the most capable transmission standard for the distance of the “last mile” over the copper wires to the customer, following on from ISDN, ADSL, ADSL2, ADSL2+ and VDSL. With a bandwidth of up to 100 megabits per second, VDSL2 enables triple-play, combining the transmission of several television channels in HDTV quality, voice transmission, and a high-speed Internet connection. In the home, too, we see continuous development in connecting consumer electronic devices, by wireline or by wireless. Home gateway solutions operate as integrated access points, combining voice, video, and data services, and work as routers to set up and control home networks.

The right product for every trend

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

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

--- Letter to the shareholders, p. 4

In the field of wireless communications, Infineon has played a leading role in the transition of high-frequency transceivers from BiCMOS to CMOS production technology. Infineon has introduced SMARTi SD in high production volumes to the market, the world’s first single-chip CMOS transceiver for GSM and GPRS, followed by --> **SMARTi PM** for EDGE and --> **SMARTi 3G** for UMTS.

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

At high speed along the last mile

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

Research and development and joint ventures

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

Infineon innovations

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

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

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

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

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

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

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

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

Did you know that ...

- high-capacity servers use up to 512 gigabytes of memory, equivalent to the memory capacity of approximately 1,000 conventional PCs?
- the next game console generation will come with a memory capacity of 512 megabytes, equivalent to that of a PC today?
- more money is spent on games software in the United States than on movie tickets, and that there are now 18,000 different computer games all over the world?
- smart phones now have 64 megabytes of memory, equivalent to a PC's memory capacity just six years ago?
- around 125 songs in MP3 format can be stored on a 512-megabyte flash card?

New products, new markets, new customers

Digitalization, the processing and handling of information packed in bits and bytes, has had a profound and highly visible effect on consumer electronics. At last, without compromising quality, data can now be copied, compressed and even transmitted and modified with ease.

The digitalization of image and sound has led to a veritable technical revolution among end devices. Up to 15,000 songs can now be stored digitally on MP3 players' hard drives. Photographers have turned digital, using cameras that save images on handy memory cards and let them work on, and print out pictures on their PC at home. Game consoles are also becoming ever more popular. Because the current generation of consoles is increasingly equipped with high-performance graphics memory, their importance for the DRAM market continues to grow.

The boom in digital and video cameras, mobile phones, and PDAs is driving demand for energy-saving DRAMs and non-volatile flash memory. The latter has become the fastest growing memory segment precisely because of the portability of the end devices.

Market researchers expect mid-range and high-end mobile phones to be fitted with between 512 megabytes and one gigabyte of memory by 2010, thus lagging the memory capacity of PCs by only five to seven years.

Infineon makes the right memory for all these products.

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Memory Products
Rapid and innovative in the memory business

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

The memory business – cyclical and fast-moving

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

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

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

The ever-growing diversity of mobile gadgets such as digital cameras, smart phones, and PDAs increasingly requires memory components with low energy use. Energy-saving memory is, however, also necessary for high-capacity servers and notebook graphics systems, as a means of keeping heat generation to a minimum when the devices are used at full power. Our DRAM products are outstandingly energy-efficient.

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

Reacting flexibly to market conditions

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

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

less price fluctuation. We are convinced that, in this way, we will be able to improve the profitability of our memory segment.

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

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

Expansion of development and production

We began the volume production of memory chips at our 300-millimeter facility in Richmond, Virginia, in September 2005. We will continue to rely on cooperative agreements in the future to expand our production capacity, and to develop new products and processes. In this way, risks and costs can be shared, while projects are given a broader resource and financial base. Our production agreements with Winbond in Taiwan and SMIC in China are both running according to plan. SMIC's new 300-millimeter facility in Beijing commenced operations using our 110-nanometer technology. SMIC is also producing products for us at a 200-millimeter facility near Shanghai. Together with Nanya, we are running the manufacturing joint venture, Inotera Memories, from which Infineon receives half of all manufactured goods. We transferred our 90-nanometer technology to Inotera at the end of 2005. We also expanded our longstanding development collaboration with Nanya: in addition to our joint development of 90-nanometer technology, and combined activities currently underway on 70-nanometer technology, we will now also work together on 60-nanometer technology.

--- Infineon's sites worldwide, p. 28; --- Operating and financial review, p. 50

Infineon innovations

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

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

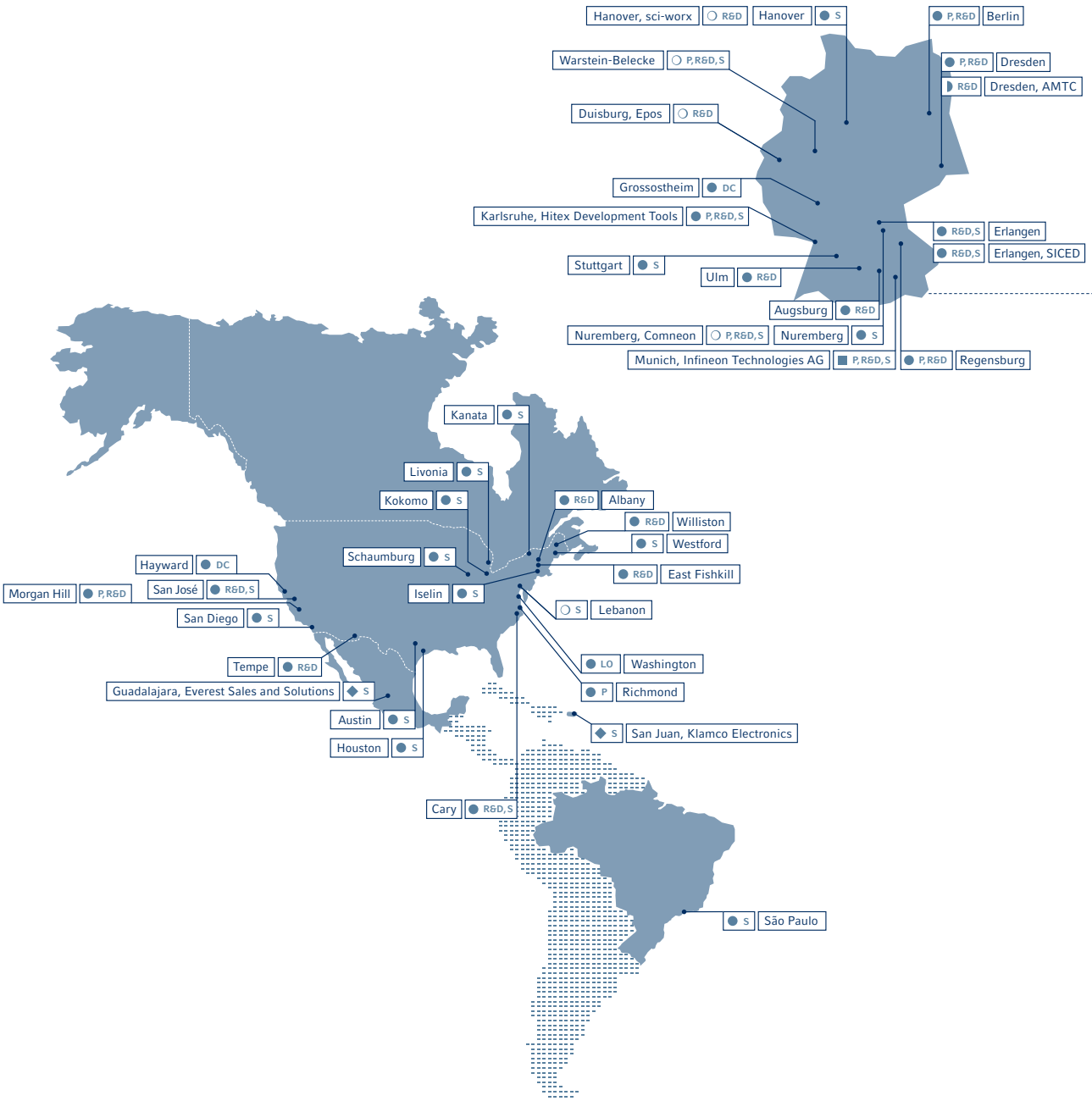
FB-DIMM
Latest servers will be equipped with this memory module format (Fully Buffered Dual-Inline Memory Module) by the end of 2005. The required AMB (Advanced Memory Buffer) is a complex logic chip that combines signals and transmits them via data lines to the processor at high speeds. Infineon is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

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

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

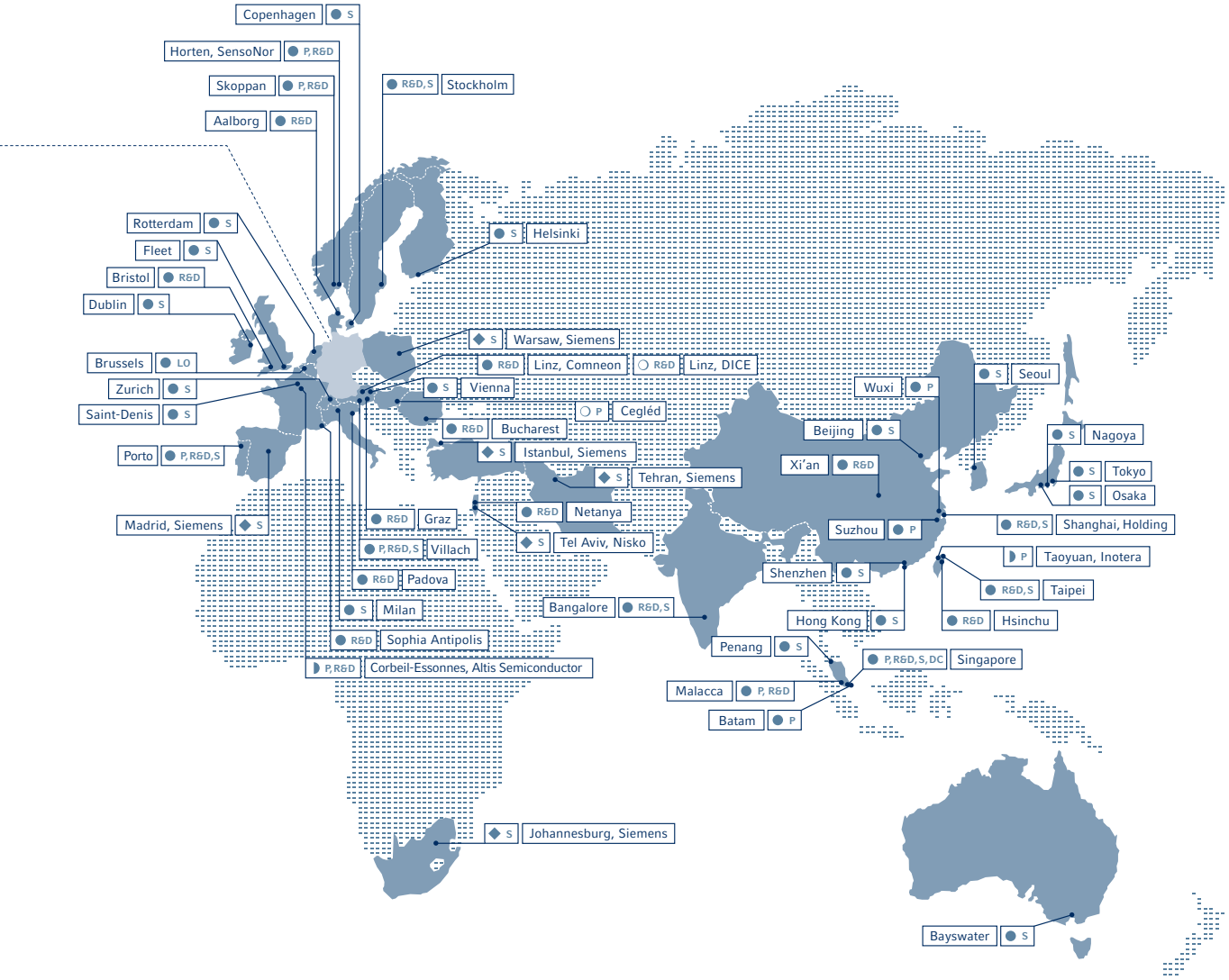
Micro-DIMM
Small memory module format for sub-notebooks.

Infineon's sites worldwide



Infineon: sites and representatives (as of October 2005)

Countries with Infineon presence	Joint venture	P Production	DC Distribution Center
Infineon headquarters	Majority holding	R&D Research & Development	LO Liaison Office
Infineon	Representative office	S Sales	


Copenhagen S
Horten, SensoNor P, R&D
Skoppan P, R&D
Aalborg R&D
R&D, S Stockholm
Rotterdam S
Fleet S
Bristol R&D
Dublin S
S Helsinki
S Warsaw, Siemens
Brussels LO
Zurich S
Saint-Denis S
R&D Linz, Comneon
R&D Linz, DICE
S Vienna
P Cegléd
R&D Bucharest
Porto P, R&D, S
S Istanbul, Siemens
S Tehran, Siemens
Madrid, Siemens S
R&D Graz
R&D Netanya
S Tel Aviv, Nisko
P, R&D, S Villach
R&D Padova
S Milan
Bangalore R&D, S
R&D Sophia Antipolis
P, R&D Corbeil-Essonnes, Altis Semiconductor
S Johannesburg, Siemens
Wuxi P
S Seoul
Beijing S
S Nagoya
Xi'an R&D
S Tokyo
S Osaka
Suzhou P
R&D, S Shanghai, Holding
P Taoyuan, Inotera
Shenzhen S
R&D, S Taipei
Hong Kong S
R&D Hsinchu
Penang S
P, R&D, S, DC Singapore
Malacca P, R&D
Batam P
Bayswater S

Did you know that ...

- some 36,400 employees from 107 nations work for Infineon?
- some 7,400 employees in research and development propose one dozen innovations every working day?
- in financial year 2005, our employees developed and implemented ideas valued at over €160 million in total, as part of Infineon's Your Idea Pays (YIP) ideas management program?
- our International Graduate Program is aimed at exceptional graduates and comprises a small, exclusive group of participants from seven countries?
- Infineon, as one of the first semiconductor manufacturers worldwide, is a member of the Global Compact, a voluntary UN initiative?

Corporate Social Responsibility

Taking our responsibilities seriously – towards society, employees, and the environment

All our decisions are based on high ethical and legal standards.
Health, occupational safety, and environmental protection are key features of all our business processes.
Our employees participate in social issues at work and worldwide.

As a globally active Company, Infineon bears great responsibility towards society and the world in which we operate; we take this task very seriously. We have a very clear vision of ethical management, one which we consistently put into practice. Corporate Social Responsibility is a critical aspect of all our business and social activities, and for this reason it is of fundamental importance that we meet the relevant legal standards and regulations in the countries in which we are active. Only with this all-embracing approach can we ensure optimal conditions both within our business environment and for our employees.

Corporate Social Responsibility (CSR)

Infineon's commitment to Corporate Social Responsibility extends over many sectors and covers many business activities. This dedication to socially responsible behavior is self-evident for Infineon.

Meeting ethical and social standards

Our strategic considerations and their implementation in our daily business have to fulfill high ethical and legal requirements. For our Company, these are described in our Business Conduct Guidelines, which contain binding principles for ethical, social, and environmentally sensitive behavior. Each of our employees is responsible for ensuring that our Company meets its societal responsibilities. In the workplace, we support equal opportunity for all, regardless of, for example, race, age, gender, disability, union status, or political allegiance, and thus support an open, communicative corporate culture. Infineon was, for example, one of the world's first semiconductor companies to join the United Nations' Global Compact. This initiative, launched by Secretary General Kofi Annan in 2000, is based on ten principles surrounding environmental protection, occupational safety, human rights, proper working conditions, anti-discrimination, and anti-corruption. By joining the Compact, we have committed ourselves to uphold these principles and to support the initiative unconditionally.

--- Corporate Governance, p. 46

Social and ethical principles have not simply been adopted within our organization. Infineon promotes Corporate Social Responsibility throughout its business relationships. Services carried out by our contractors, and all products, materials, equipment, and systems that we purchase are required to meet our standards with respect to environmental protection, occupational safety, health, and social conditions.

Environmental protection and occupational safety

At Infineon, the health of our employees, occupational safety, and environmental protection form a key part of our corporate responsibility and our business processes. Motivation and training of our employees are also very important to us. At Infineon, it has been and will continue

to be a matter of great concern to reach all-embracing social, economic, and ecological goals in the day-to-day production and development of complex semiconductors and system solutions. That is why environmental protection remains critical for us at all our sites, and also during development of new products and manufacturing processes. Environmental protection, as we understand it, does not simply mean conserving nature. We also consider this to embrace product-related environmental protection, transportation of hazardous materials, and management of emergency procedures, as well as certain aspects of occupational health and safety such as chemical safety.

Several years ago, we introduced our environmental management system, which includes a process of continuous improvement. Our production sites are multi-site certified in accordance with the EN ISO 14001 standard, and new sites are prepared to meet its strict requirements. In addition, our worker protection management system was matrix-certified according to OHSAS 18001 (Occupational Health and Safety Assessment Series) at the end of 2005. Also in 2005, we established IMPRES (Integrated Management Program for Environment, Safety, and Health) at the Company, which comprises all processes, strategies, and related health, occupational safety, as well as environmental targets.

Even our products conserve the environment

Sustainability is not only a question of environmentally friendly production. Even our products contribute to conserving the environment, for example by reducing the power consumption of household appliances, or fuel consumption of car engines, and thus reducing the emission of harmful gases.

--- Automotive, Industrial and Multimarket, p. 16

Our ambitious program to meet our environmental goals and requirements provides our customers with the greatest environmental responsibility and legal security. This has been confirmed by independent experts and by our customers for a long time. In 2005 for example, Infineon has been officially recognized by Samsung as an Eco Partner and was recertified by Sony as a Green Partner.

The numerous awards we have won for our services indicate that we are truly on the right track. We present our ESH (Environment, Safety, and Health) Award each year in order to recognize the achievements of our employees. Employees are honored for sustainable new developments, and for innovative measures that improve Infineon's high environmental and occupational safety standards even further.

Worldwide employee participation

Good ideas are, of course, worthless if they are not put into practice. Each of our employees must thus subscribe to, and act according to, our principles of Corporate Social Responsibility. We are thus actively committed to health and education at all our sites, promoting occupational safety and as well as protection of the environment. Behind Infineon's activities and initiatives are our workforce, which becomes personally involved in a variety of ways, donating blood or collecting relief aid following natural disasters such as the Asian tsunami in 2004, and the flood in New Orleans/Louisiana, USA, in 2005.

Junior staff also receive particular attention as a part of our social agenda, particularly when addressing the problem of unequal opportunity. We have begun a number of programs around the world to help needy young people receive a proper education and training, often working closely together with regional and international schools and universities. We are also involved in a number of training and education initiatives to provide future generations with an easier route to learning. Examples are programs for trainees, the active participation in Girls' Day, which has been introduced to raise girls' interest in science and technology; and the Young Professionals Program, which provides extra support to exceptional trainees.

We all know that it is often small things that make the greatest differences. As a responsible member of society, Infineon makes significant contributions in many different fields.

More information about Infineon's commitment to Corporate Social Responsibility can be obtained directly from the Company. Infineon will publish a sustainability report in 2006.

People at Infineon
Four key principles guide our thoughts and actions

Infineon's new mission statement's four key principles form the basis of our corporate culture. The willingness to initiate and implement change continually is critical to our market success. Our employees' deep and diverse knowledge enables us to arrive at innovative solutions.

Infineon's four key principles – the basis of our corporate culture

Infineon's key principles for future success are **customer focus**, **operational excellence**, **profitable growth**, and **collaborative leadership**. These are not only meant to guide our daily work together, but also to direct the very way we think and act. In practice, this means that we think first of our customers and their market needs. We do so by setting standards with regard to costs, quality, and speed, concentrating on profitable growth in the interest of our shareholders and employees. Cooperative leadership provides the basis for our actions. Working as a global team, we do all we can to help our customers achieve success.

Our senior management bears particular responsibility for the implementation of the Company's four guiding principles. Management is not only expected to show exemplary behavior, but also to support employees in acting according to the principles of Infineon's mission statement. The principles of collaborative leadership are fundamental to our Leadership Charter, mandatory for every manager at Infineon.

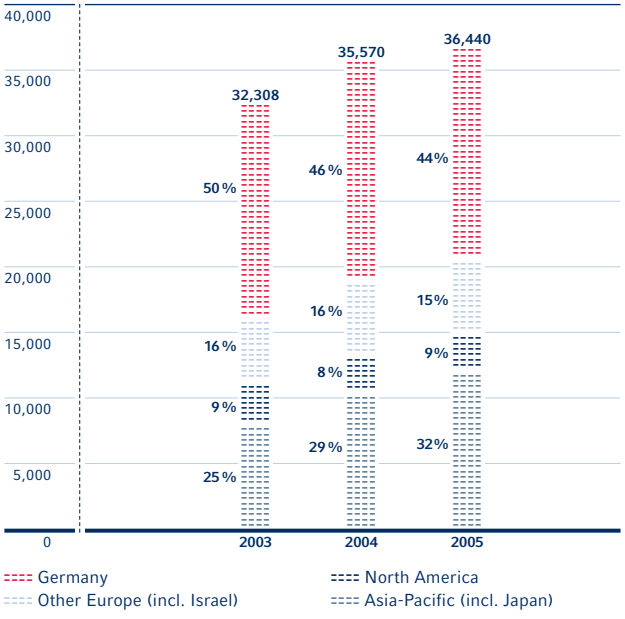
Dedicated employees, international markets

In the fast-moving semiconductor industry, it is important to us, to strengthen our ability to innovate, to boost our efficiency, and to improve the quality of our products and performance. Enthusiastic and dedicated employees able to work independently on sophisticated tasks are vital. Our employees' dedication has among others been demonstrated by the success of Your Idea Pays (YIP), our ideas management program. Suggestions made by individuals and teams range from cost-saving process improvements to ideas enabling us to raise customer satisfaction with lasting effect. This past financial year, suggestions for improvements made by some 11,500 employees led to over €160 million in savings, an increase of 10 percent. Compared to other large German companies, we are at the forefront with our employee suggestions program; the "Deutsches Institut für Betriebswirtschaft" again ranked us first among large electronics companies this year.

We support our employees' collaborative work in teams and networks even across international borders, something which contributes greatly to our success in global competition. It is thus particularly important to us that our employees view themselves as a global team, and take for granted cooperation across cultural boundaries. Infineon is truly an international company with employees from 107 nations at sites in 24 countries, which thrives on the cultural diversity of its staff. For example, not only do individuals from 45 different countries work at our site in Dresden, Germany, but they also cooperate closely on 90-nanometer production with sites in Richmond, Virginia, and in Taiwan.

--- Memory Products, p. 24

Employees by region



We support corporate change

The 2005 financial year was also a year of organizational change at Infineon. The goal of such change is always to improve the efficiency of our Company, and to make certain that we realize our full potential. We place particular emphasis on the optimal organization of strategy, structure, processes, and culture. We actively support our employees throughout the process of corporate change so that they can adapt while continuing to identify with "their Company" even in times of significant change.

--- Letter to the shareholders, p. 4

In this context, we have among others expanded our intercultural workshop program considerably to meet the demand posed by the continual growth of international projects, providing support for the numerous international project teams that have emerged from the Company's reorganization. We are also placing increased emphasis on promoting communication between technicians, management, and marketers, establishing various new forums for experts to exchange ideas and information. In this way, we are contributing to better networking and coordination across the most divergent areas of our Company, a major requirement for the success of our new corporate structure.

A learning organization

Continuous personal development, based on the principle of life-long learning, forms a cornerstone of our human resources strategy. This revolves around the communication of relevant expertise and experience, together with the development of ideas directly related to our business. In addition to technical training, our employees can choose from many possible training programs, both general and specialized. We particularly value the interdisciplinary nature of all our employee development programs. Our project management seminars for technicians, for example, focus on developing leadership qualities and basic business skills. We also offer "learning solutions", customized training programs that aim to meet the specific needs of our individual operating segments. E-learning is playing an ever-increasing role in our fast-paced industry, as it allows for flexible learning and the rapid transfer of expertise across the globe.

At the same time, new employees benefit from their colleagues' knowledge derived from years of experience, even across international borders. Some 400 employees from our new plant in Kulim, Malaysia, for instance, have been assigned to our sites in Villach, Austria, and Regensburg, Germany, to profit from the experience of our staff there. This transfer of expertise is of primary importance in the establishment of our new Malaysian site.

--- Automotive, Industrial and Multimarket, p. 16

Recruiting and retaining talent

Only by achieving excellence in everything we undertake can we thrive in global competition in the long term. Thus we wish to attract the best talent to enable us to stay at the top of our industry in research, development, and production for years to come. Retaining such talent is, however, of even greater importance to us. We therefore offer our employees promising career opportunities, both technical and managerial. We take an international approach as common place. When on assignment at one of Infineon's sites around the world, employees take the opportunity to contribute their expertise, adding value for themselves personally and the Company.

We support working practices that ensure smooth operations during peak periods and help us to meet our customers' particular needs rapidly. Within Germany, we also encourage our employees to strike a career-life balance through part-time and telework.

Rewarding extraordinary work is a matter of course at Infineon. Our annual Infineon Awards and Team-of-the-Month Awards are but two examples of how we regularly honor individual and team excellence within the Company. Our four key principles also play a key role. One of

the 2004 Infineon Awards was presented to a project which impressively demonstrates how Infineon successfully deploys its global partnership network even with complex structures, thereby fulfilling a major precondition for profitable growth. The award-winning team "UMCI production readiness for the S-GOLDlite" only needed four months to launch production of 1,200 wafers for the mobile phone S-GOLDlite chipset, achieving a yield of 80 percent.

--- Communication, p. 20

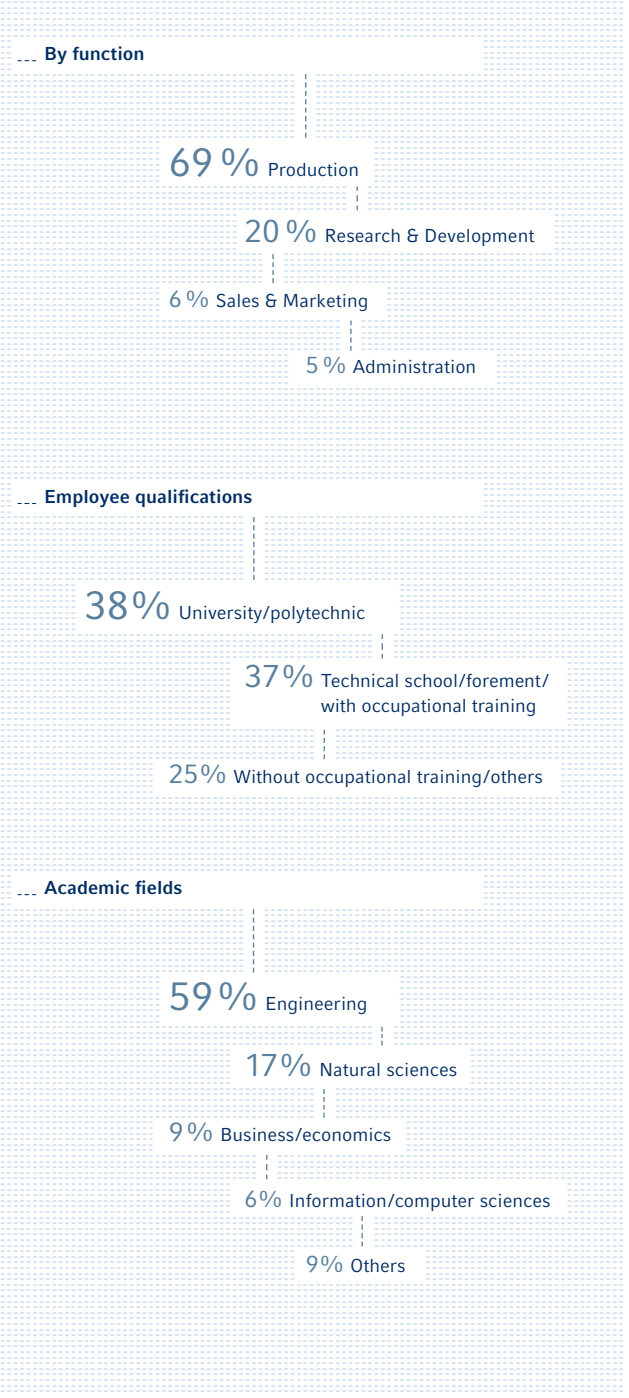
We would like our employees to take individual responsibility, and show persistence in pursuing goals critical to our Company's success. Thus we have organized a new system of variable payments for individually contracted employees in Germany starting in the 2006 financial year that reflects performance and results. This system makes the connection between performance, success, and reward more transparent, and honors the measurable contribution of individuals towards the attainment of our Company goals.

Improving cooperation with new company sites

Speed, cooperation, and physical proximity – in the last financial year, we created new company sites that meet these demands of the dynamic semiconductor sector. This characterizes not only our new corporate site Campeon near Munich, Germany, which will bring under one roof a majority of our Munich-based employees by the beginning of 2006, but also our new Asia-Pacific headquarters in Singapore, which brings together employees from a wide variety of fields. The architecture of these new buildings enhances communication, the free interdisciplinary exchange of knowledge, and the modern team and project structures that are important for work in our industry.

--- Infineon's sites worldwide, p. 28

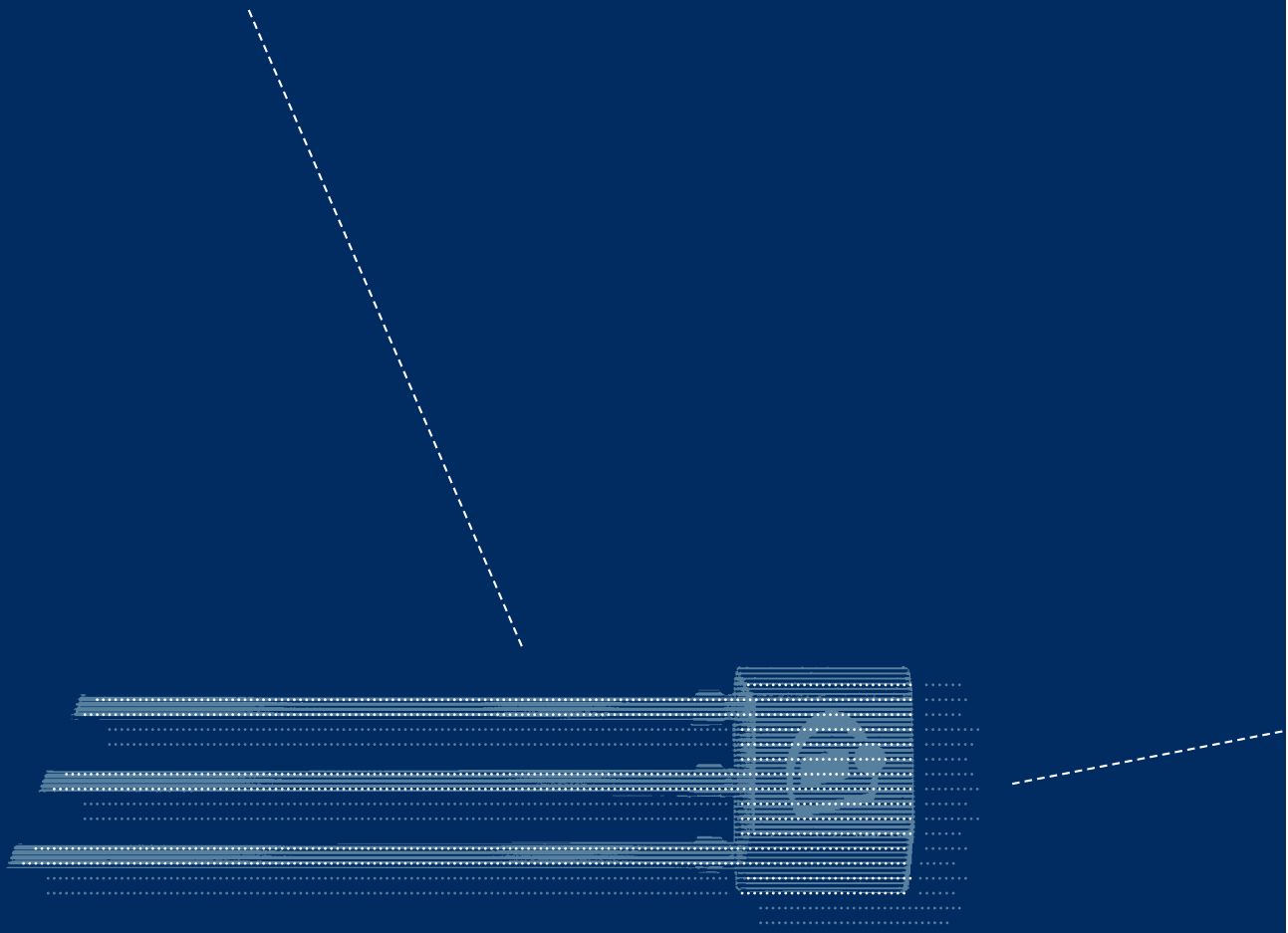
People at Infineon



All figures refer to the 2005 financial year.

HALL SENSOR

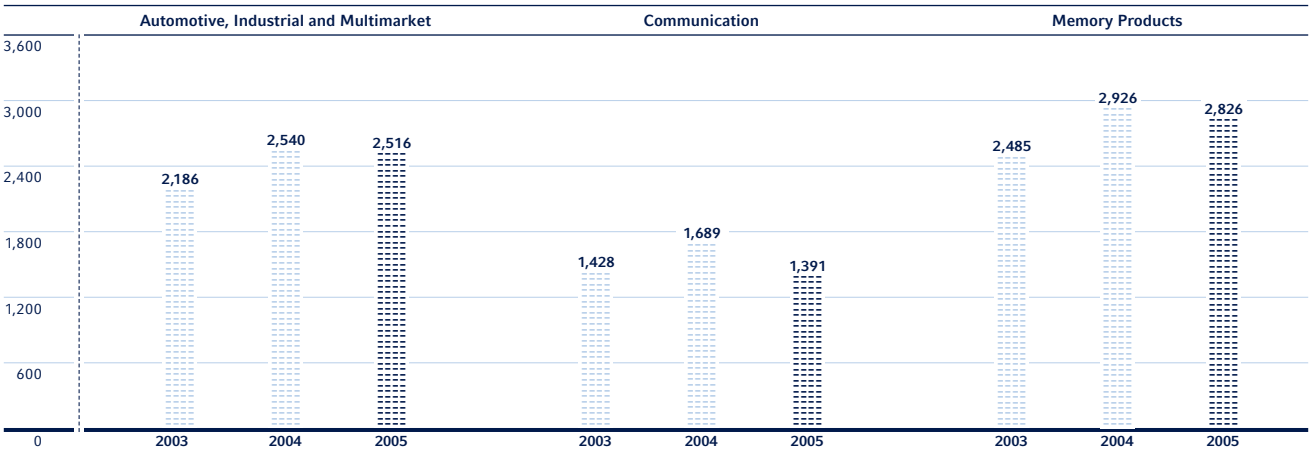
To implement the latest concepts in car safety, many physical measurements are required, whether by airbag impact or temperature sensors. Less well-known are the magnetic field sensors which monitor the position of pedals, disks, gear shifts, and switches. Highly accurate measurements are needed for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



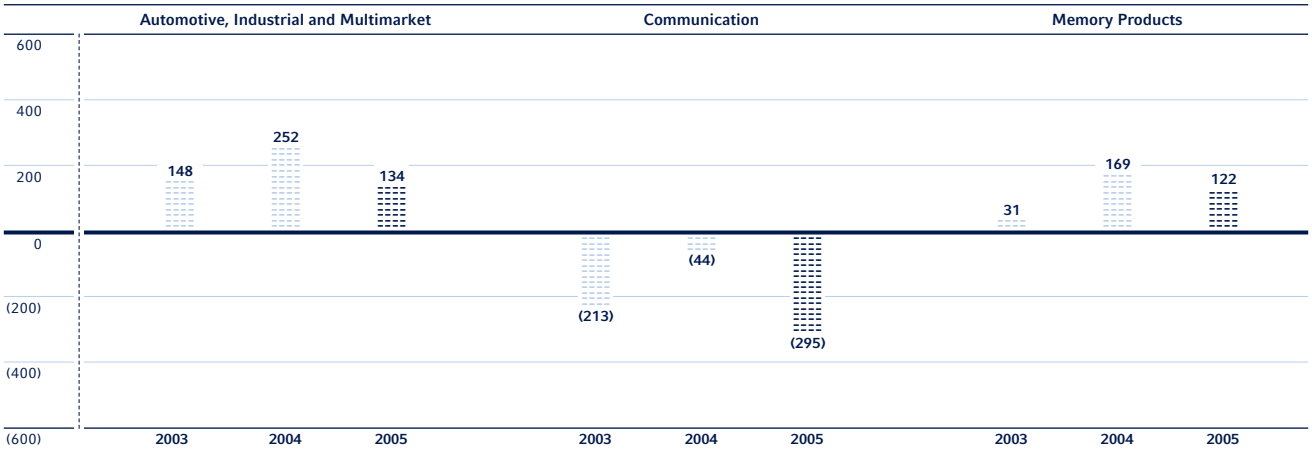
Financial review

Our segments: net sales and EBIT

Net sales € in millions



EBIT € in millions



Contents

Report of the Supervisory Board to the Annual General Meeting

Max Dietrich Kley
Chairman of the Supervisory Board of Infineon Technologies AG

Dear Shareholders,

Over the past financial year, the Supervisory Board has concerned itself intensively with the situation of the Company and its future positioning. The Supervisory Board has regularly monitored the Company's management through the Management Board, and has provided the latter with support and advice.

Main activities of the Supervisory Board. Among the issues which the Supervisory Board has dealt with in the financial year, I would particularly like to refer to the following:

--- the new organization and structure of the Company,
--- the restructuring of manufacturing cooperation between Regensburg, Munich, and Villach, and
--- dealing with events in the area of motor sport sponsorship.

At the beginning of 2005, Infineon's organizational structure was reorganized. The three operating segments Automotive, Industrial and Multimarket (AIM), Communication (COM), and Memory Products (MP) are now each led by a member of the Management Board with direct entrepreneurial responsibility. In addition, all operating segments were provided with the essential functions to operate as companies within a company. The Supervisory Board welcomes this reorganization as it improves Infineon's ability to succeed in an increasingly dynamic and volatile global semiconductor market. To this end, the Supervisory Board approved the Board's plan for the restructuring of segment functions.

The efficiency and costs of production are constantly monitored by the Management and Supervisory Boards. In an extraordinary meeting on this subject, the Supervisory Board examined the reasons presented by the Management Board for the restructuring of manufacturing cooperation between Regensburg, Munich, and Villach, and the intended closure of the Infineon plant in Munich-Perlach at the beginning of 2007. This plant is designed to manufacture semiconductors on 150-millimeter wafers using specialized technologies and can no longer be sensibly used, whether economically or technically, in the future. The cost disadvantages of 150-millimeter in comparison to 200-millimeter manufacturing are considerable and constantly increasing. For this reason, it is intended to relocate a major portion of the production activities from Munich-Perlach to Regensburg and, to a lesser extent, to Villach.

The Supervisory Board was also asked to consider a plan to make the Memory Products segment operationally independent. This concept was extensively discussed and subsequently approved. The Management Board was asked to elaborate the further steps required for the implementation of the concept and to present it to the Supervisory Board for a decision.

The allegations concerning the former Management Board member Dr. von Zitzewitz in connection with the Company's motor sport sponsorship, which was discontinued after the departure of Dr. Schumacher in 2004, were discussed at a meeting of the Investment, Finance, and Audit Committee on July 22, 2005. The Committee came to the conclusion that the Executive Committee had dealt with the case comprehensively and appropriately. Furthermore, the Investment, Finance, and Audit Committee decided to commission an independent, external investigation on the Company's internal information and control systems in order to ascertain whether there were any weaknesses in Infineon's system of controls which might have prevented the alleged misconduct of Dr. von Zitzewitz from being recognized earlier. The audit revealed no such weaknesses. The results of the audit were discussed at the meeting of the Investment, Finance, and Audit Committee on November 16, 2005, and were also presented and discussed at the meeting of the Supervisory Board on November 17, 2005.

At the meeting held on July 28, 2005, the Supervisory Board was comprehensively informed by its Chairman about the internal and external investigations carried out by the Executive Committee since the first allegations were made against Dr. von Zitzewitz in March 2004. At the end of this report there is a chronological list of the measures taken by the Supervisory Board. The Supervisory Board also came to the conclusion that the Executive Committee had dealt with the case thoroughly and correctly, and that no criticism could be leveled at the Committee. The Supervisory Board asked the Management Board to continue its investigation into the facts of the case and also to investigate whether other individuals could be responsible for inappropriate conduct in connection with motor sport sponsorship. The enforcement of any legal claims will be decided upon by the Supervisory Board once all the relevant facts are available.

At the ordinary meetings of the Supervisory Board, the Management Board reported comprehensively on the Company's corporate development, its economic situation as well as that of the individual operating segments; it also informed the Board about financial and investment planning, and presented detailed quarterly reports. In the course of its meetings, the Supervisory Board discussed in depth the information submitted by the Management Board. The Management Board also reported verbally or in writing upon incidents of particular importance. In addition, the Chairman of the Supervisory Board was continually informed about essential matters and decisions within the Company in individual talks with the Management Board.

Corporate governance. The Supervisory Board firmly believes that good corporate governance is an essential factor in the success of a company, and has regularly studied German and international corporate governance rules and their implementation in the Company. The Investment, Finance, and Audit Committee has drawn up

guidelines to address complaints and warnings of incorrect conduct concerning the presentation of accounts and auditing (known as Whistle-blowing Procedures). The 2004 Declaration of Compliance pursuant to § 161 of the German Stock Corporation Law was adopted by the Supervisory Board in November 2004, while the 2005 Declaration of Compliance was adapted in November 2005. There were only two notifiable deviations from the code. These and further details of Infineon's Corporate Governance System are described in this Annual Report.

Meetings of the Supervisory Board and the committees. During the period under review there were four ordinary meetings and one extraordinary meeting of the Supervisory Board. The Investment, Finance, and Audit Committee was convened five times in the period under review.

The Committee focused its activity primarily on the examination of the interim reports, the preliminary auditing of the annual accounts, discussion of the auditor's report with the auditors, and the examination of finance and investment plans. The Committee also discussed and approved the planned construction in Kulim, Malaysia, of a new plant for logic and power chips for automobile and industry applications. The new plant will strengthen the successful business with chips for automotive and industry applications and further develop the Company's presence in the Asian markets of the future.

The dialog between the Supervisory and Management Boards concerning technical developments is of major importance to the Company. Until April 30, 2005, the Strategy and Technology Committee, which met four times in the year in question, served to promote this dialog. The Committee concerned itself intensively with the corporate development and strategy of the Communication (COM) and Automotive, Industrial and Multimarket (AIM) segments. In addition, the Committee examined the Company's patent and cooperation strategy. The Supervisory Board decided that in the future, the exploration of questions concerning technology and strategy should be carried out outside a special body with more timing flexibility and, for this reason, dissolved the Committee on April 30, 2005. This dialog will henceforth continue between individual former members of the Committee and the Management Board in respect of specific issues and projects.

The Executive Committee held one meeting in the period under review. It was not necessary for the Mediation Committee, provided for under § 27 Section 3 of the "Mitbestimmungsgesetz" (German Codetermination Act), to be convened.

Individual and consolidated financial statements. The annual financial statements of Infineon were audited by KPMG Deutsche Treuhand-Gesellschaft AG Wirtschaftsprüfungsgesellschaft, Berlin and Frankfurt/Main. KPMG audited the individual financial statements of Infineon Technologies AG, as well as the consolidated financial statements of the Infineon Group, for the financial year ended September 30, 2005, and provided unqualified auditors' opinions. We have also examined these documents. Further, KPMG confirmed that the annual financial statements were prepared in accordance with the provisions of U.S. GAAP and that the exemption provision under § 292a German Commercial Code in connection with § 58 section 3 of the Introduction Act to the German Commercial Code (EGHGB) was applicable.

The reports by KPMG on the audit of the annual accounts and the consolidated financial statements were presented to all members of the Supervisory Board and dealt with in detail at the meeting of the Investment, Finance, and Audit Committee on November 16, 2005, and subsequently during our financial statements meeting on November 17, 2005, in the presence of the auditors. At this meeting the Management Board reported in detail on the scope, key areas and costs of the audit. The Supervisory Board found no grounds for objections and agreed with the results of the audit, approving the consolidated financial statements and the operating and financial reviews of Infineon Technologies AG and of the Infineon Group. The annual report and accounts are thus completed.

Management Board changes. In November 2004 the Supervisory Board appointed Mr. Loh to become a member of the Management Board. Mr. Loh assumed responsibility for the Communication segment in December 2004 and for the Memory Products segment in July 2005. In July 2005 Dr. von Zitzewitz resigned from his position as a member of the Management Board. The Supervisory Board accepted his resignation. Prof. Dr. Eul was appointed as a deputy member of the Board in July 2005 and took over responsibility for the Communication segment from Mr. Loh.

Composition of the Supervisory Board. At the Annual General Meeting held on January 25, 2005, Prof. Dr. Köcher, Prof. Dr. Schmitt-Landsiedel and Mr. Feldmayer were elected to become members of the Supervisory Board. Dr. Faber, Dr. Jentzsch, Mr. Kley, Prof. Dr. Winterkorn and Prof. Dr. Wucherer were re-elected as members of the Supervisory Board. Mr. Fritsch, Dr. Kohlhaussen and Prof. Dr. Ruge stepped down from their positions as members of the Supervisory Board at the end of the 2005 Annual General Meeting. We would like to express our thanks to the departing members of the Supervisory Board for their dedicated work in this forum.

At the ordinary Supervisory Board meeting on January 25, 2005, Mr. Kley was appointed as its Chairman and Mr. Luschtinetz as its Vice-Chairman.

The Supervisory Board would like to express its thanks to the Management Board and all Infineon employees for their efforts and their performance in the 2005 financial year. The Supervisory Board would also like to thank the members of the Works Council for their constructive participation.

Munich, November 2005

On behalf of the Supervisory Board

Max Dietrich Kley
Chairman of the Supervisory Board

Annex to the Supervisory Board's Annual Report 2005

SUMMARY OF THE SUPERVISORY BOARD'S ACTIONS IN INVESTIGATING EVENTS IN MOTOR SPORT SPONSORSHIP

1 Directly before resigning from office on March 25, 2004, Dr. Schumacher handed a number of documents, which did not originate from him, to the chairman of the Supervisory Board. One of them was a statutory declaration by Ralf-Udo Schneider, the owner of BF Consulting. In this declaration, Mr. Schneider alleged to have given Dr. von Zitzewitz payments from "sponsorship funds". The other documents also contained various allegations against Dr. von Zitzewitz, which later proved to be untenable or were expressly retracted.

2 Immediately on receipt, the chairman of the Supervisory Board asked Dr. von Zitzewitz for an explanation and comment upon these documents. Dr. von Zitzewitz repeatedly denied to the chairman of the Supervisory Board the assertions made in the declaration of Mr. Schneider.

3 At the same time and shortly before becoming acting president and CEO, Mr. Kley, as chairman of the Executive Committee, instructed the general counsel on the same day to investigate the allegations on behalf of the Supervisory Board. Besides ascertaining the facts, the investigation was to establish what immediate consequences the Supervisory Board must draw from the fact of the existence of the "declaration" and the other documents. In addition, independent lawyers were briefed to examine these questions.

4 In the week commencing March 29, 2004, the general counsel held several discussions, including discussions with Mr. Schneider. The latter flatly refused to present any proof whatsoever and was unable to give any conclusive reasons at all for the alleged payments.

5 The independent lawyer presented a first expert opinion on the allegations at the beginning of April 2004, a second followed mid-April. Both concluded that there were no indications of, let alone supporting documents for, any misconduct on Dr. von Zitzewitz's part.

6 At the same time as the independent examination, the internal examination led to a report of April 21, 2004, for the Supervisory Board. This report also concluded that there were no supporting documents verifying the accusations leveled against Dr. von Zitzewitz.

7 The Executive Committee of the Supervisory Board conferred on this report on April 22, 2004. In consideration of all the circumstances (absence of any evidence whatsoever; no responsibility whatsoever on Dr. von Zitzewitz's part for motor sport sponsorship; considerable skepticism as to Mr. Schneider's credibility, for reasons including his refusal to clarify the facts), the Supervisory Board reached the conclusion that there was no reason to dismiss Dr. von Zitzewitz from office due to breach of duty.

8 In a separate move, the Supervisory Board gave orders at the end of April 2004 that further light be thrown on the facts and any new findings be communicated to the Board immediately. The Company repeatedly called upon BF Consulting, in writing and verbally, to submit all relevant documents and to present evidence for the allegations. All these requests were ignored and evidence was never presented.

The investigations (including an audit at BF Consulting) finally showed that BF Consulting had consistently overcharged on contracts involving Infineon. In addition, it seemed that significant sums of money to which Infineon is entitled had been withheld from Infineon, namely from the co-sponsorship of racing cars. Yet the audit did not produce any indication whatsoever of payments having been made to Dr. von Zitzewitz or to other persons at Infineon.

BF Consulting refused a second, more extensive, audit subsequently scheduled for February 2005.

9 Independently of the internal investigations, Infineon terminated the business relations with BF Consulting for cause. BF Consulting brought an action against the termination before the Regional Court (Landgericht) Munich. On the occasion of the hearing in November 2004 the allegations against Dr. von Zitzewitz were again publicized in the press. Infineon immediately called upon Mr. Schneider yet again to present supporting documents. The request was also put to Mr. Schneider directly in the hearing. Mr. Schneider again refused to furnish any evidence supporting his allegations. Further, in a statement to the press BF Consulting expressly retracted these allegations on November 22, 2004.

10 Once Infineon had gained sufficient information showing BF Consulting's conduct in breach of contract, Infineon brought an action against BF Consulting before the Arbitration Court in February 2005. This action directly lays claim on the one hand to €1.6 million and, on the other, demands information on funds due to Infineon amounting to an estimated further €3 million.

11 Independently of this, the District Attorney's Office in Munich investigated Mr. Schneider and other persons. The Supervisory Board and Managing Board had been unaware of these investigations until July 15, 2005. On that date, July 15, 2005, the District Attorney's Office carried out a search at Infineon and questioned Dr. von Zitzewitz. Dr. von Zitzewitz later submitted his resignation in order to focus on his defense in presumably lengthy proceedings and not to burden the Company.

12 Immediately following the search by the District Attorney's Office, the chairman of the Supervisory Board – acting in agreement with the Managing Board – again instructed the Legal Department to evaluate the facts in the light of new findings and to clarify them further.

13 It is self-evident that further investigations are addressing the allegations against Dr. von Zitzewitz and the facts themselves. This investigation is being undertaken without prejudice to its outcome in any way. The Supervisory Board wishes to establish the true facts and will therefore examine with all the other persons involved in motor sport sponsorship whether there is any indication of misconduct. The Company is cooperating fully with the legal authorities.

14 The Supervisory Board will also examine in this process whether the Company has a claim for damages against the persons concerned. If the investigation shows that such a claim exists, the Supervisory Board will make a decision about its enforcement.

Corporate Governance
An integrated concept

Corporate Governance means setting standards for good and responsible corporate leadership.

Infineon's Management Board and Supervisory Board view Corporate Governance as an integrated concept, which includes all corporate values, processes and goals that underlie our corporate mission. It encompasses internal controlling standards, our Business Conduct Guidelines, the regulation of the Company's organizational and supervisory tasks, Infineon's Corporate Governance Code as well as a Corporate Governance Manager, who reports directly to the Management and Supervisory Boards.

We have of course subjected our Corporate Governance to review, prompted by the events and allegations in connection with our earlier motor sport sponsorship. The objective of these internal and external inquiries was to find out whether our rules and internal control systems have any flaws preventing the detection of possible misconduct. The inquiries have showed that this is not the case. Nevertheless we have, independently of these allegations, extended the already initiated improvements to our internal guidelines.

In this way we seek to achieve our goals – and to belong to those companies with the best Corporate Governance.

INFINEON MAINTAINS HIGH GERMAN AND INTERNATIONAL STANDARDS

German regulations

Infineon has adopted almost all of the regulations that have been recommended or suggested by the Government Commission "German Corporate Governance Code", and is also fully compliant with the standards set down in U.S. capital markets law. With regard to the directors' and officers' liability insurance, we have, for example, agreed to a retention amounting to 25 percent of the fixed annual remuneration for members of the Management Board and 100 percent for members of the Supervisory Board.

Above and beyond the "German Corporate Governance Code", Infineon has set itself further goals for good corporate management and control:

- We will continue to report fully and comprehensively about the Company to our shareholders and the public.
- We intend to support shareholders as far as possible in the exercise of their rights. Via the Internet, shareholders can, for example, register for our Annual General Meeting, participate in voting, or follow the general debate online.
- We shall further strengthen cooperation between the Management Board and the Supervisory Board. In order to achieve our goals, we will continue to promote a positive climate of mutual respect and open dialog.

American capital market rules

Infineon Technologies AG is listed on the New York Stock Exchange (NYSE). The Company is therefore subject to American capital market legislation, as well as to rules of the American Securities and Exchange Commission (SEC) and NYSE. Since July 2002, the U.S. legislator, the SEC and the NYSE have issued various rules for improvement of investor protection and the Corporate Governance guidelines for U.S. companies. Most of these rules also apply to non-U.S. companies listed on U.S. stock exchanges.

We have already fulfilled most of these new guidelines. To implement further the U.S. regulations, we have set up a Disclosure Committee with the task of examining and releasing financial information and other important information for publication. We have also put an internal certification procedure into place, requiring senior staff who bear managerial responsibility to confirm certain data. This procedure and these endorsements are used for the CEO and CFO certifications of SEC filings. Further, we have revised or created further rules, including a Code of Procedure for the Audit Committee of the Supervisory Board; moreover, we have established rules for financial statement and accounting-related complaints and for the relationship to the auditor.

THE STRUCTURE OF CORPORATE MANAGEMENT AND CONTROL

Supervisory Board

German Stock Corporation Law, to which Infineon Technologies AG is subject as a German stock corporation, stipulates a two-tier corporate management and oversight system, namely, corporate management by the Management Board and corporate oversight by the Supervisory Board. We feel confident that this separation of the two functions is an essential prerequisite for good Corporate Governance.

The Supervisory Board comprises 16 members who, in accordance with German Codetermination Act, represent in equal numbers the shareholders and the employees. The shareholder representatives are elected by the Annual General Meeting, most recently in the 2005 financial year. Employee representatives are elected in accordance with the requirements of the German Codetermination Act. The employee representatives are elected by delegates of the workforce at Infineon's German sites. Six of these employee representatives are employees of the Company and two are external appointees proposed by certain German unions.

Pursuant to the Supervisory Board rules of procedure, the shareholder representatives on the Supervisory Board must be independent. Some of the members of the Supervisory Board hold or held high-ranking positions in other companies with which Infineon usually maintains business relations. These relations are at the same conditions as they would be to any third party. The employee representatives – with one exception – are also considered to be independent in the sense of the rules applicable to this Company. Accordingly, after examining the situation, the Supervisory Board concluded that it had an adequate number of independent members.

The term of office of the Supervisory Board generally lasts five years. Over recent years, the Supervisory Board has assembled for meetings between five and seven times per year and these meetings were regularly held without the presence of the Management Board. The duties and the working methods of the Supervisory Board and its Committees are laid down in procedural rules which also contain stipulations about independence, adequate experience and specialized knowledge as well as the avoidance of conflicts of interest.

The Supervisory Board advises and monitors the Management Board in the performance of its executive duties. It scrutinizes business development and planning, business strategy and its implementation. It examines the quarterly reports and approves the annual financial statements of Infineon Technologies AG and of the Group, drawing on preparatory work by the Audit Committee and the auditors' reports. Key decisions of the Management Board such as major acquisitions, divestitures, and financial measures are subject to the Supervisory Board's consent. The Supervisory Board also decides about the appointment and dismissal of the members of the Management Board.

Committees of the Supervisory Board

The rules of procedure of the Supervisory Board make provision for the formation of three committees; further committees can be formed ad hoc. The tasks, responsibilities and working methods of these committees fulfill the requirements of the German Corporate Governance Code and the binding regulations of the U.S. American laws and the NYSE; to some extent we even go beyond the rules which are applicable to us.

The Executive Committee, composed of two shareholder representatives and one employee representative, has the role of a "Nominating, Compensation and Corporate Governance Committee", since it is responsible for preparing the appointment of members of the Management Board, for their remuneration and for adherence to the principles of Corporate Governance throughout the Company. The Executive Committee lays down the conditions of employment as well as the level and structure of remuneration for the Management Board. It also decides on the level of the stock-related component of the remuneration.

The Investment, Finance and Audit Committee ("Audit Committee") consists of two shareholder representatives and one employee representative. All the members of the Audit Committee are "independent" in the sense of the relevant U.S. regulations. The Audit Committee monitors the appropriateness and the efficacy of the Company's external and internal reporting, examines the quarterly and the annual reports presented by the Management Board and, on the basis of the report on the annual financial statements issued by the external auditor, makes suggestions for the finalization of the annual statements by the Supervisory Board. It also deals with the Company's system of internal controls and the procedure for risk assessment, control and management. To this end, it is able to refer directly to all employees and to call in external support. The internal auditor reports regularly to the Committee, which can also determine the audit plan and its key areas of interest. In addition, the Committee also oversees adherence to legal provisions and official regulations. It is responsible for the relationship between the Company and the auditor of the annual financial statements, for commissioning the auditor and specifying the audit's key areas, and for the payment of the auditor.

The Supervisory Board has appointed Mr. Max Dietrich Kley as the Audit Committee Financial Expert.

The Mediation Committee, which consists of one shareholder representative and two employee representatives, makes proposals to the Supervisory Board regarding the appointment of members of the Management Board if the first round of the election does not produce the required majority of two-thirds of the members of the Supervisory Board.

Remuneration paid to members of the Supervisory Board

In the past financial year, the members of the Supervisory Board received the following gross remuneration:

Name	Total remuneration in €	of which the variable part is
Kley, Max Dietrich	58,000.00	0
Luschtinetz, Klaus	43,500.00	0
Eibl, Alfred	37,458.00	0
Faber, Dr. Joachim	35,041.00	0
Feldmayer, Johannes	19,333.00	0
Hauser, Jakob	37,458.00	0
Fritsch, Günther	9,666.00	0
Jentzsch, Dr. Stefan	29,000.00	0
Köcher, Prof. Dr. Renate	19,333.00	0
Kohlhaussen, Dr. h.c. Martin	14,500.00	0
Ruth, Michael	29,000.00	0
Ruge, Prof. Dr. Ingolf	14,500.00	0
Scheitor, Dieter	29,000.00	0
Schmidt, Gerd	29,000.00	0
Schmitt-Landsiedel, Prof. Dr. Doris	22,958.00	0
Schulzendorf, Kerstin	29,000.00	0
Trüby, Alexander	37,458.00	0
Winterkorn, Prof. Dr. Martin	39,875.00	0
Wucherer, Prof. Dr. Klaus	37,458.00	0

Management Board

The Management Board of Infineon Technologies AG – currently five members – is the Company's executive body. It is held to serve solely the Company's interests and thereby aims to pursue a sustained increase in shareholder value. In compliance with the mandatory provisions of the German Stock Corporation Law, it bears overall responsibility for the value-creating, operative management of the Company. In accordance with its own rules of procedure, all the members are jointly responsible for the management of the Company. On December 1, 2004, the Management Board was reorganized: as of this date three members of the Board each hold direct responsibility for one operating segment. Nevertheless, all essential decisions will continue to be discussed and taken by the entire Management Board.

Shareholders and Annual General Meeting

Shareholders of the Company take their decisions at the Annual General Meeting of the Company which is held at least once a year. Every share has one vote. Every shareholder who is entered in the register of shareholders and enrols in time is entitled to attend this meeting. The Annual General Meeting of shareholders decides on all the issues assigned to it, especially discharging the Management Board and the Supervisory Board as well as the election of the auditor, and it decides upon amendments to the articles of incorporation and any capital reorganization. In the interest of best Corporate Governance, the German legislator has always prescribed that any form of capital reorganization must be subject to the approval of the shareholders of the Company. Such measures include stock-option plans which are realised with shares in the Company. Shareholders are entitled to make counter-proposals to the motions introduced by management and, under certain circumstances, have the right to contest resolutions of the Annual General Meeting and to demand a judicial review when they suspect misconduct or severe deficiencies in the Company's management or supervision.

We report to our shareholders four times a year, strictly in accordance with the financial calendar, on the Company's performance, its financial situation and profitability. Moreover, members of the Management Board regularly inform investors, analysts and the public about the quarterly and annual results. Our extensive investor relations activity includes regular meetings with analysts and institutional investors as well as annual analysts' conferences and telephone conferences and generally seeks to maintain a continuous dialog with shareholders and analysts.

ONGOING EVALUATION OF GUIDELINES

The Management Board, Supervisory Board and top management are responsible for ensuring that our Corporate Governance rules and regulations are actively observed in the Company. At regular intervals these guidelines are evaluated and further developed. Thus in 2005 we reexamined whether the remuneration of members of the Management Board should be revealed individually. The reappraisal came to the following conclusion:

In compliance with the mandatory provisions of the German Stock Corporation Law and with its own rules of procedure, all the members of the Management Board are jointly responsible for the value-creating operative management of the Company. Naturally, we keep our shareholders informed of the structure of the Management Board's remuneration and specify the total remuneration paid to the Management Board, broken down into fixed salaries, performance-related components and stock options, so that every shareholder can clearly see how the performance of the Management Board impacts upon its income. Accordingly, we do not see any necessity for the individual publication of the remuneration paid to each member of the Management Board.

However, Dr. Ziebart, the Chairman of the Management Board, has decided to disclose his remuneration (see page 131).

The total income of the members of the Management Board is composed of the annual salary (payable in cash), of stock options and of additional non-cash benefits. The annual salary consists of:

- a fixed annual salary payable in monthly installments, partly after the end of the financial year, net of statutory deductions, and
- a variable, performance-related component which takes the form of an annual bonus.

In the 2005 financial year, the annual bonus depended primarily on the return on assets, which we define as net operating profit after taxes, minus exceptional effects, in proportion to capital employed. A bonus can also be awarded for special business achievement. The annual bonus is paid after the end of the financial year.

As a variable component of their remuneration, which combines both long-term incentive and risk, members of the Management Board are granted options on Infineon Technologies AG shares deriving from the 2001 stock option plan. They also receive ancillary benefits such as, for example, retirement pensions and provisions for surviving dependants, continued remuneration in the event of sickness and a company car including a driver, which may also be used for private purposes.

The full text of our 2001 stock options plan is available on the Internet at www.infineon.com/stockoptionsplan2001. This plan expires in 2006. A new stock options plan will therefore be proposed to the 2006 Annual General Meeting. The essential features of this plan are the introduction of an additional relative success target (outperforming a relevant index) and the raising of the minimum share price increase to 20%. Senior managers and employees of the Infineon Group should only benefit from an increase in the share price when the owners have achieved a certain minimum return on their investment.

Further improvements to the rules of Corporate Governance

We conduct our business in a responsible way in accordance with legal requirements and official regulations – and we have set up a number of guidelines which help to ensure that this objective is fulfilled. Our Business Conduct Guidelines are binding for the Management Board and employees. We reviewed these guidelines in 2005, and revised particularly the regulations regarding the filing and treatment of complaints and suggestions of breaches of these guidelines and of the rules governing accounting and the preparation of financial statements. A Compliance Officer and the Corporate Governance Manager, who both report to the Audit Committee, receive complaints and suggestions, also those filed anonymously. The Business Conduct Guidelines also contain our Code of Ethics in Financial Matters, and are published on our Internet website.

Improvements to Infineon's Corporate Governance Code

We have made further improvements to the provisions of our own Corporate Governance Code. Here we have adopted the new rules and recommendations of the German Corporate Governance Code issued in the summer of 2005. Accordingly, in November 2005, the Management Board and the Supervisory Board decided to issue the 2005 Declaration of Compliance pursuant to § 161 of the German Stock Corporation Law. We are pleased to have been able to improve our Corporate Governance Standard.

Formal notification under paragraph 6.6 of the "German Corporate Governance Code"

In the past financial year the following transaction was registered with the Company:
Date of the transaction: 2005-01-27
Surname, name: Kley, Max Dietrich
Position held: chairman of the Supervisory Board
Title: shares of Infineon Technologies AG
Purchase/Sale: purchase
Price (each): Euro 7.15
No. of units: 7,000
Volume of transaction: Euro 50,050.00
Location: Stock Exchange Frankfurt (Xetra)

2005 Declaration of Compliance pursuant to § 161 of the German Stock Corporation Law

"Since the submission of the 2005 Declaration of Compliance pursuant to § 161 of the German Stock Corporation Law, Infineon Technologies AG has complied with all the recommendations of the Government Commission "German Corporate Governance Code" (in the version of May 21, 2003) with the following exceptions:

- We do not publish an individualized statement of all Management Board Members' remuneration (Section 4.2.4).
- The structure of the Management Board remuneration system (Section 4.2.2) was deliberated and agreed by the Executive Committee of the Supervisory Board.

Infineon Technologies AG will comply with all the recommendations of the Government Commission "German Corporate Governance Code" (in the version of June 2, 2005) with the following exceptions:

- We publish an individual statement of the remuneration of the Chairman of the Management Board, but otherwise relinquish individual disclosure of the remuneration of all the other members of the Management Board (Section 4.2.4).
- The structure of the Management Board remuneration system (Section 4.2.2) will be deliberated and agreed by the Executive Committee of the Supervisory Board."

Further information on Corporate Governance in general is available on the Internet at www.infineon.com, "Investor Information". Further information about the activities of the Supervisory Board and its Committees is contained in the Report of the Supervisory Board. Information on our risk management is given under "Risks and Opportunities". A detailed description of our rules of consolidated accounting is contained in the Notes annexed to the Consolidated Financial Statements.

Report of the Supervisory Board, p. 40; Risks and Opportunities, p. 73;
Notes to the Consolidated Financial Statements, p. 86.

Operating and financial review

Important note

This discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and other financial information included elsewhere in this annual report. Our audited consolidated financial statements have been prepared on the basis of a number of assumptions more fully explained in Note 1 (Description of Business, Formation and Basis of Presentation) and Note 2 (Summary of Significant Accounting Policies) to our audited consolidated financial statements appearing elsewhere in this annual report.

OVERVIEW OF THE 2005 FINANCIAL YEAR

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

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

- The Mobile business and Wireline Communication segment were combined into the new Communication segment to align our structure with market developments. At the same time, the security and chip card activities and the ASIC & Design Solutions business were integrated into the extended Automotive, Industrial and Multimarket segment.
- Our revenues decreased by 6.1 percent, from €7,195 million in the 2004 financial year to €6,759 million in the 2005 financial year. Our earnings before interest and taxes (EBIT) decreased from positive €256 million in the 2004 financial year to negative EBIT of €183 million in the 2005 financial year.
- Our cash flow from operations decreased from €1,857 million in the 2004 financial year to €1,039 million in the 2005 financial year. The reduction was due mainly to decreased gross margin and changes in various current liabilities.
- We and ProMOS Technologies Inc. ("ProMOS") reached an agreement regarding ProMOS' license of our previously transferred technologies, pursuant to which ProMOS may continue to produce and sell products using those technologies and to develop its own processes and products. As full consideration, ProMOS agreed to pay us $156 million in four installments through April 30, 2006. The parties agreed to withdraw their respective claims.

- We consummated the acquisition of Saifun Semiconductors Ltd.'s ("Saifun") remaining 30 percent share in the Infineon Technologies Flash joint venture. As part of this acquisition, Saifun granted us a license for the use of Saifun NROM® technologies.
- We sold certain assets of our fiber optics business to Finisar Corporation ("Finisar") in exchange for 34 million shares of Finisar's common stock, which were subsequently sold.
- We sold our interest in Infineon Ventures GmbH, including the majority of the venture investments held therein.
- We and Rambus Inc. ("Rambus") reached an agreement settling all claims between us and providing for a worldwide license to us of the Rambus patent portfolio for use in our current and future memory products.
- We agreed upon restructuring measures aimed at reducing costs, downsizing our workforce, and consolidating certain functions and operations. In connection with these measures, restructuring charges of €78 million were recognized during the 2005 financial year.
- We recognized impairment charges of €134 million in the 2005 financial year, principally related to our remaining fiber optics businesses, the reorganization measures within our Communication segment and long-term investments.
- We continued to invest heavily in research and development and achieved a number of significant milestones during the year, including the introduction of:
  - E-GOLDradio, the latest member of our successful E-GOLD family, integrating the complete functionality of our baseband chip, E-GOLDlite, and our sophisticated quadband RF transceiver, SMARTi SD2;
  - 90-nanometer DRAM trench technology and demonstration of first functional parts on 70-nanometer DRAM trench technology;
  - VINAX, our new VDSL2 chip solution, designed for applications ranging from low-end modems to high-end home gateways;
  - SMARTi 3G, the latest member of our successful UMTS transceiver family, designed to be used in mobile applications and supporting currently specified UMTS bands I through VI worldwide;
  - a new 8/16/32 bit microcontroller with embedded Flash for use in industrial and automotive applications;
  - the new space-saving production method FCOS (Flip Chip On Substrate) developed jointly with Giesecke & Devrient GmbH ("Giesecke & Devrient"); and
  - a new Trusted Platform Module (TPM), a complete independent hardware and software solution according to the specification of Trusted Computing Group.
- As part of our ongoing project to improve our production processes and expand our production capabilities, we:
  - successfully transferred to different production facilities our high-performance process technology using structure sizes of 130-nanometer for logic products, in order to further increase our production flexibility;
  - successfully introduced the 90-nanometer process technology for DRAM products in our 300-millimeter production facility at Dresden;
  - expanded the scope of our joint development agreement with Nanya Technology Corporation ("Nanya") to include next generation 60-nanometer DRAM trench technology;
  - saw our joint venture Inotera ramp up to approximately 60,000 wafer starts per month several months ahead of schedule;
  - saw the 300-millimeter facilities at our plant in Richmond, Virginia, and at our foundry partner Semiconductor Manufacturing International Corporation ("SMIC") in Beijing, China, start commercial production;
  - started manufacturing at our memory chip assembly and testing facilities in Suzhou, China;
  - started the construction of a new front-end production plant in Kulim High Tech Park, Malaysia, with a total planned investment of approximately $1 billion. The facility will mainly produce power and logic chips used in automotive and industrial power applications; and
  - formed a new development center in Bucharest, Romania, with a principal focus on power ICs including analog and digital functions.

OUR BUSINESS

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

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

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

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

THE SEMICONDUCTOR INDUSTRY AND FACTORS THAT IMPACT OUR BUSINESS

Our business and the semiconductor industry are highly cyclical and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. Although these factors affect all segments of our business, they are especially pronounced in our Memory Products segment, are increasingly true of our Communication segment, and have the least impact on our Automotive, Industrial and Multimarket segment.

Cyclicality

The industry's cyclicality results from a complex set of factors, including, in particular, fluctuations in demand for the end products that use semiconductors and fluctuations in the manufacturing capacity available to produce semiconductors. This cyclicality is especially pronounced in the memory portion of the industry. Semiconductor manufacturing facilities (so-called fabrication facilities, or "fabs") can take several years to plan, construct, and begin operations. Semiconductor manufacturers have in the past made capital investments in plant and equipment during periods of favorable market conditions, in response to anticipated demand growth for semiconductors. If more than one of these newly built fabs comes on-line at about the same time, the supply of chips to the market can be vastly increased. Without sustained growth in demand, this cycle has typically led to manufacturing overcapacity and oversupply of products, which in turn has led to sharp drops in semiconductor prices. When prices drop, manufacturers have in the past cut back on investing in new fabs. As demand for chips grows over time, without additional fabs coming on line, prices tend to rise, leading to a new cycle of investment. The semiconductor industry has generally been slow to react to declines in demand, due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of planned expansion.

We attempt to mitigate the impact of cyclicality in the memory business by investing in our manufacturing capacities throughout the cycle and entering into alliances and foundry manufacturing arrangements that provide flexibility in responding to changes in the cycle. We believe that we can improve our gross margin in the memory business by focusing on two key areas: the continuous improvement of cost structure and productivity through the introduction of advanced memory process technologies and the development and marketing of a broader

range of memory products, focusing particularly on higher margin and less volatile applications such as infrastructure, high-end graphics, consumer and mobile applications.

Substantial capital and R&D expenditures

Semiconductor manufacturing is very capital-intensive. The manufacturing capacities that are essential to maintain a competitive cost position require large investments in manufacturing assets. The top 10 capital spenders in the industry, of which we rank number 8 according to IC Insights, account for more than 50 percent of the industry's average capital expenditure. Manufacturing processes and product designs are based on leading-edge technologies that require considerable research and development expenditures. A high percentage of the cost of operating a fab is fixed; therefore, increases or decreases in capacity utilization can have a significant effect on profitability.

Because pricing, for DRAM products in particular, is market-driven and largely beyond our control, a key factor for us in achieving and maintaining profitability is to continually lower our per-unit costs by reducing our total costs and by increasing unit production output.

To reduce our total costs, we also aim to share the costs of research and development and manufacturing facilities with third parties, either by establishing alliances or through the use of foundry facilities for manufacturing. We believe that cooperation in alliances for R&D and manufacturing and foundry partnerships provide us with a number of important benefits, including the sharing of risks and costs, reducing our own capital requirements, allowing us to develop a broader range of products, acquiring technical know-how, and gaining access to additional production capacities. We are developing future DRAM technologies with feature sizes of 70-nanometer and 60-nanometer together with Nanya. In addition, we have established foundry relationships with partners in Asia, including SMIC and Winbond Electronics Corp., Hsinchu, Taiwan ("Winbond"), to increase our manufacturing capacities, and therefore our potential revenues, without investing in additional manufacturing assets. In our logic area, our principal alliances are with International Business Machines Corporation ("IBM"), Chartered Semiconductor Manufacturing Ltd. ("Chartered Semiconductor"), and Samsung Electronics Co. Ltd. ("Samsung") for CMOS development and manufacturing at 65-nanometer and 45-nanometer process technologies, with United Microelectronics Corporation ("UMC") for 90-nanometer manufacturing, and with IBM through our manufacturing joint venture ALTIS Semiconductor S.N.C. ("ALTIS") in Essonnes, France.

We expect to increase unit production output through improvements in manufacturing, which is achieved by producing chips with smaller structure sizes (more bits per chip) and by producing more chips per silicon wafer (by using larger wafers). For DRAM process technology, the majority of our capacity is based on 110-nanometer structure sizes. In addition we have started commercial production based on 90-nanometer structure sizes, jointly developed with Nanya. We have extended our 300-millimeter capacity share during the 2005 financial year with the continuous ramp up of our joint venture with Nanya, Inotera, and the start of ramp-up of foundry capacities at SMIC in Beijing and our own facility in Richmond. We plan to further extend the share of our memory production on 300-millimeter wafers with the continuous ramp-up of our 300-millimeter line in Richmond and the additions of capacities at our foundry partner Winbond in the 2006 financial year. In our logic area, the majority of our capacity is based on 130-nanometer structure sizes. Our 130-nanometer logic process technology, with up to eight layers of copper metallization, is in full production at several manufacturing sites, including our Dresden facility and our manufacturing joint venture with IBM in Essonnes, France. We are currently in the process of ramping up production of several products using our 90-nanometer logic technology and have also begun qualification of our 65-nanometer logic process technology.

Technological development and competition

Sales prices per unit are volatile and generally decline over time due to technological developments and competitive pressure. Memories in particular are commodity-type products. Since most specifications are standardized, customers can switch between suppliers on short notice. This leads to strong competition within the market, and causes manufacturers to pass cost savings on to their customers in an effort to gain market share. Logic products are generally not commodities, but rather have a certain degree of application specification. Although generally less volatile than those for commodity memory products, unit sales prices for logic products typically decline over time as technological developments occur.

We aim to offset the effects of declining unit sales prices on total revenues by optimizing product mix, and by increasing unit sales volume and residual effects on gross margin by continually reducing per-unit production costs. The growth in

volumes depends in part on productivity improvements in the manufacturing of semiconductor chips. By moving to ever-smaller structure sizes in manufacturing, the number of functional elements has historically doubled approximately every two years. This trend, often called Moore's Law, has led to an average growth rate of bit-volumes of between 40 percent and 45 percent per year and, assuming constant costs per square inch of silicon, to an approximately 30 percent cost reduction per bit per year.

Seasonality

Our business is affected by seasonality, with sales historically stronger in our fourth financial quarter and weaker in our first and second financial quarters. The seasonality of our sales reflects the seasonal demand fluctuations for the products that incorporate our semiconductors. If anticipated sales or shipments do not occur when expected, expenses and inventory levels in that quarter can be disproportionately high, and our results of operations for that quarter, and potentially for future quarters, may be adversely affected.

Product development cycles

For logic products, the cycle for test, evaluation, and adoption of our products by customers before the start of volume production can range from several months to more than one year. Due to this lengthy cycle, we may experience significant delays from the time we incur expenses for research and development, marketing efforts, and investments in inventory, to the time we generate corresponding revenue, if any. Development cycles affect memory products to a lesser extent due to the higher degree of standardization for memory products.

Acquisition and divestiture strategy

A key element of our business strategy involves the acquisition and divestiture of businesses, assets, products, or technologies to reduce the time required to develop new technologies and products and bring them to market, and to optimize our existing product offerings, market coverage, engineering workforce, or technological capabilities. We plan to continue to evaluate strategic opportunities as they arise, including business combination transactions, strategic relationships, capital investments, and the purchase or sale of assets.

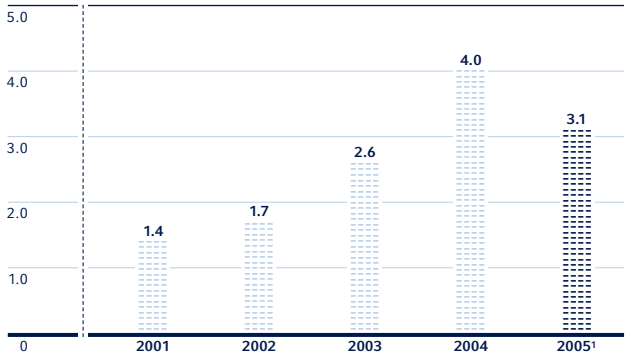
Intellectual Property

Due to the high-technology nature of the semiconductor industry, Intellectual Property (IP), meaning intangible assets relating to proprietary technology, is of significant importance. Companies that have their own patented IP often allow third parties to use their IP in exchange for license fees. It can be costly and difficult to defend against infringement by third parties, or to defend the Company against claims by third parties of infringement of their technology. We do not record assets in our balance sheet for self-developed IP. Only IP licensed from others or acquired through a business acquisition is reflected on our balance sheet, and reduced through amortization over its expected useful life. The value of such acquired IP is often complex and difficult to estimate.

CHALLENGES THAT LIE AHEAD

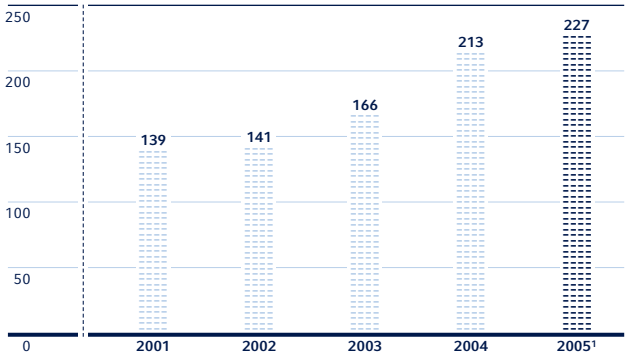
Going forward, our success will remain highly dependent on our ability to stay at the leading edge of technology development, and to continue to optimize our product portfolio. We must achieve both objectives to ensure that we have the flexibility to react to fluctuations in market demand for different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

World economic growth in %



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

Development of the semiconductor market U.S. $ in billions



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

SEMICONDUCTOR MARKET CONDITIONS IN THE 2005 FINANCIAL YEAR

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

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

PLANS FOR A NEW SET-UP OF OUR COMPANY

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

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

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

Background

Our business includes both the memory semiconductor activities of our Memory Products segment and the logic semiconductor activities of our two applications segments, Automotive, Industrial and Multimarket, and Communication. The memory and logic sides of our business have historically benefited from certain synergies, but we believe that the two lines of business will diverge in significant respects, reflecting differences in both technological innovation and economics, and that these synergies will therefore decrease. In particular, the memory business continues to be characterized by a highly capital-intensive drive to continuously update and improve manufacturing processes and cost position. The logic business, on the other hand, is evolving into an application/solution-driven model, which requires continuous product development and specialized manufacturing. The intense capital demand of the memory business reflects the need to invest continuously in very costly, efficient and up-to-date fabrication facilities and leading-edge manufacturing technologies. The logic business operates on a smaller manufacturing scale. Certain parts of it (our "advanced logic business" consisting mainly of mobile phone baseband ICs and a range of chip card, wired communication, microcontroller, and other customer-specific ICs) are well-prepared to make use of foundry manufacturing capacity for standard semiconductor manufacturing processes (so-called CMOS technology). Certain other parts of it, mainly our power and RF-IC businesses, can rely on sophisticated, significantly less capital-intensive manufacturing processes mastered in-house as an important competitive differentiator. In addition, the technologies employed in the two lines of business are expected to increasingly diverge, resulting among other things in differing development roadmaps – with memory disproportionately focused on process technologies – and the need for strategic and development alliances with different partners. The synergies in design methodologies and tools are likewise becoming very limited. Finally, the two lines of business are subject to very different financial market dynamics – which may be less than fully transparent to investors in the combined business.

RESULTS OF OPERATIONS

Reorganization

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

Consequently, we are now organized into three principal segments, two of which are application-focused – Automotive,

Results of Operations expressed as percentages of net sales

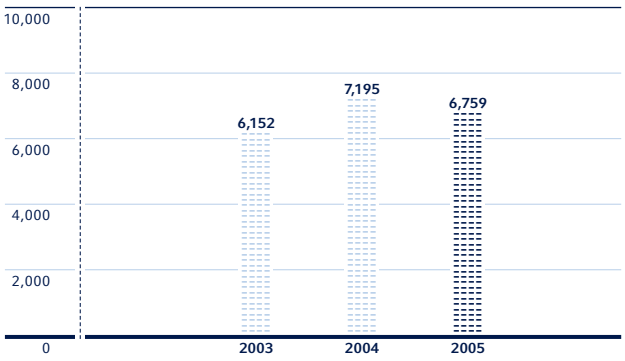
For the years ended September 30[1]	2003	2004	2005
Net sales	100.0	100.0	**100.0**
Cost of goods sold	(75.0)	(64.9)	**(72.6)**
Gross margin	25.0	35.1	**27.4**
Research and development expenses	(17.7)	(16.9)	**(19.1)**
Selling, general, and administrative expenses	(11.0)	(10.0)	**(9.7)**
Restructuring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

1 Columns may not add due to rounding.

Industrial and Multimarket, and Communication; and one of which is product-focused – Memory Products. These groups design, develop, manufacture, and market a broad range of semiconductors and complete system solutions used in a wide variety of microelectronic applications.

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

Net sales € in millions



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

Net sales

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

- Our logic products, which include a wide array of chips and components used in electronic applications ranging from wireless communication devices (such as mobile phones and Bluetooth devices), chip cards, modems, and other wireline technologies such as DSL, automotive electronics, and industrial applications.
- Our memory products, such as dynamic random access memory (DRAM) products, which are used in computers and other electronic devices. We also offer a limited range of non-volatile flash memory products, which are used in consumer applications such as digital still cameras or mobile handsets.

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

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

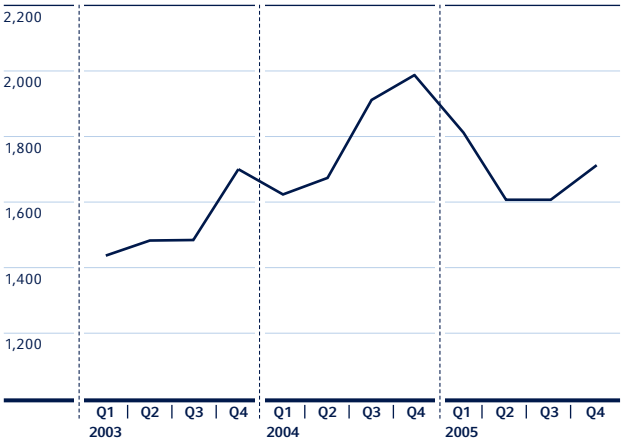
Our revenues fluctuate in response to a mix of factors, including the following:

- the market prices for our products, particularly our memory products;
- our overall product mix and sales volumes;
- the stage of our products in their respective life cycles; and
- the effects of competition and competitive pricing strategies.

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

The increase in net sales in the 2004 financial year was mainly driven by higher demand for memory products and semiconductors used in mobile phones, as well as the continued strong performance of the Automotive, Industrial and Multimarket segment. In the 2005 financial year, net sales decreased primarily due to lower demand for products of the wireless business and declining prices for DRAM products. License income decreased in the 2004 financial year mainly as a result of a reduction in license revenues from ProMOS. In the 2005 financial year, license income increased primarily due to the settlement reached with ProMOS, whereby €118 million in license income was recognized. The decline of major foreign currencies (primarily the U.S. dollar) relative to the euro during the 2003, 2004, and 2005 financial years negatively impacted reported sales. The effect of foreign exchange over the prior year is calculated as the estimated change in current year sales if the average exchange rate for the preceding year is applied as a constant rate in the current year. The increase in revenues from entities we acquired since the beginning of the prior year reflects primarily the inclusion of a full-year consolidation of sales in the year after the initial acquisition.

Quarterly net sales € in millions



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

Net sales by segment

--- Automotive, Industrial and Multimarket

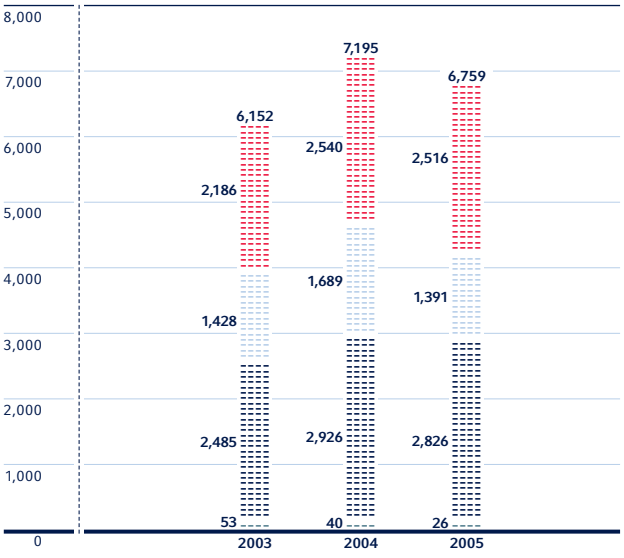
The segment experienced continued growth in the 2004 financial year as volume growth, particularly for automotive power applications (reflecting the increasing semiconductor content in automotive electronics), more than offset ongoing price pressure caused by technological developments and competition.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

--- Communication

In the 2003 financial year and the first half of the 2004 financial year, we experienced increasing demand for digital access products as the need for DSL Internet-based communication increased, and markets in developing countries improved. An offsetting trend was the decrease in demand for traditional analog communication products, which was more pronounced in the second half of the 2004 financial year than in prior periods. Sales growth in the 2004 financial year occurred primarily in the second half of the year, as demand for mobile solutions accelerated. In the 2005 financial year, sales in the Communication segment declined year-on-year due to a revenue decrease in the wireless business, primarily caused by a decline in demand from some customers for baseband components beginning in the second quarter of the 2005 financial year, as well as continued pricing pressure. This decline could not be offset by the stable sales trend in the wireline business.

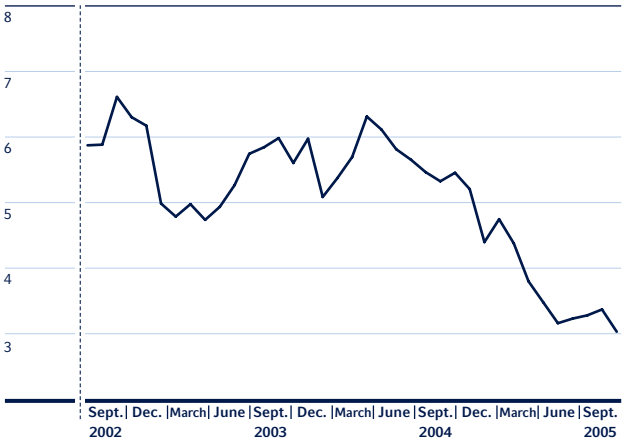
For the years ended September 30	2003 € in millions	%	2004 € in millions	%	2005 € in millions	%
Automotive, Industrial and Multimarket	2,186	36	2,540	35	**2,516**	**37**
Communication	1,428	23	1,689	24	**1,391**	**21**
Memory Products	2,485	40	2,926	41	**2,826**	**42**
Other Operating Segments	21	–	11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

Net sales by segment € in millions



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

DRAM price development per 256-Mbit-equivalent in U.S.$



Source: WSTS

Memory Products

The increase in net sales in the 2004 financial year was due mainly to higher volumes, which more than offset the impact of an unfavorable U.S. dollar/euro exchange rate and lower license income. Sales volumes in the 2004 financial year also benefited from the ramp-up of our Dresden 300-millimeter facility, from the conversion to 110-nanometer technology and from access to additional capacity made available through our cooperation with Winbond and SMIC, which offset the reduced volume of products we purchased from ProMOS. Overall megabit volume increased during the 2004 financial year as a result of increasing market demand for personal computers and system memory. Net sales in the 2005 financial year declined compared to the previous year mainly due to price pressure, especially in the first half of the financial year, which could not be compensated by increasing bit shipments and increased revenues from licenses and Flash memory products. In addition, the continued unfavorable U.S. dollar/euro exchange rate further contributed to the revenue decline. Production volumes increased during the 2005 financial year primarily as a result of the ramp-up of our manufacturing joint venture Inotera and the access to additional capacity through our cooperation with Winbond and SMIC. Overall, megabit sales volume increased during the 2005 financial year as a consequence of increasing market demand, particularly for personal computers and system memory. The majority of our memory products sales were based on 256-Mbit DRAMs in the first half of the 2005 financial year and of 512-Mbit DRAMs in the second half of the 2005 financial year, as the market shifted to the next higher-density product generation.

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

Other Operating Segments

Net sales remained relatively unchanged in the 2005 financial year.

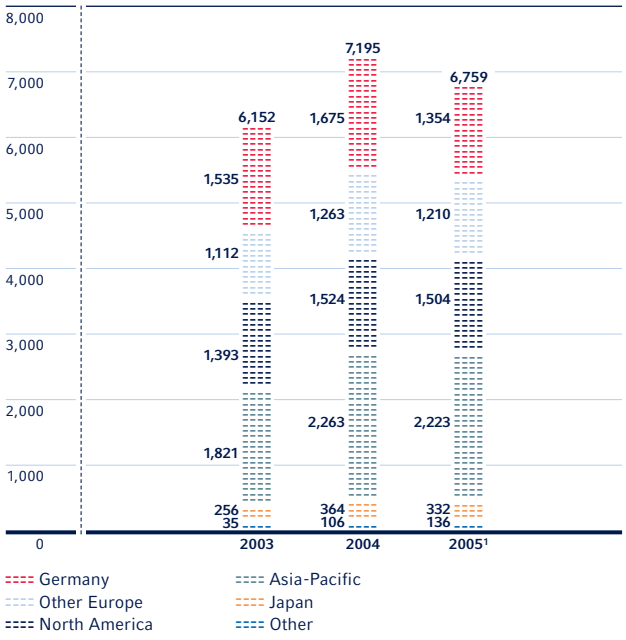
Net sales by region and customer

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

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

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

Net sales by region € in millions



Shift of sales from Germany to other European countries.

Net sales by region

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

Cost of goods sold and gross margin

Our cost of goods sold consists principally of:
--- direct materials, which consist principally of raw wafer costs;
--- labor costs;
--- overhead, including maintenance of production equipment, indirect materials, utilities, and royalties;
--- depreciation and amortization;
--- subcontracted expenses for assembly and test services;
--- production support, including facilities, utilities, quality control, automated systems, and management functions; and
--- foundry production costs.

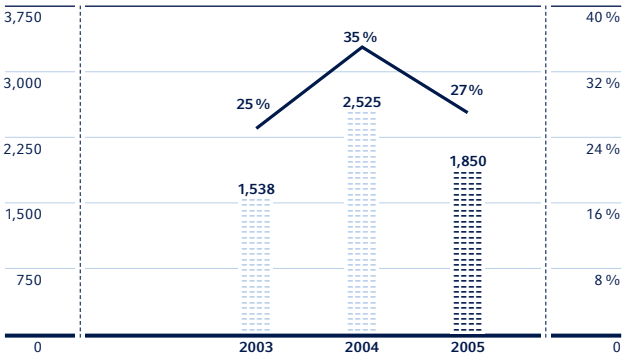
In addition to factors that affect our revenue, our gross margin is impacted by:
--- factory utilization and related idle capacity costs;
--- amortization of purchased intangible assets;
--- product warranty costs;
--- provisions for excess or obsolete inventories; and
--- government grants, which are recognized over the remaining useful life of the related manufacturing assets.

We report as cost of goods sold the cost of inventory purchased from our joint ventures and other associated and related companies such as ALTIS, Inotera, and, through January 1, 2003, ProMOS. Our purchases from these affiliated entities amounted to €615 million in the 2005 financial year, €357 million in the 2004 financial year, and €470 million in the 2003 financial year.

For the years ended September 30	2003	2004	2005
Cost of goods sold € in millions	4,614	4,670	**4,909**
Changes year-on-year		1 %	**5 %**
% of net sales	75 %	65 %	**73 %**
Gross margin	25 %	35 %	**27 %**

The gross margin improvement during the 2004 financial year was attributable to a variety of factors, including improved integration and higher capacity utilization in most of our operating segments, a substantially improved cost position in our Memory Products segment, and a better overall pricing environment than in the prior financial year. Our gross margin deteriorated in the 2005 financial year, primarily as a result of higher idle capacity costs and strong pricing pressure in most of our operating segments, as well as the unfavorable U.S. dollar/euro exchange rate, particularly in our Memory Products segment, which could not be entirely offset by productivity measures.

Gross margin absolute € in millions
and as percentage of net sales in %



Pricing pressure and idle capacity costs could not be entirely offset by productivity improvements.

The gross margin development in our operating segments was as follows:

--- Automotive, Industrial and Multimarket

In the 2004 financial year, gross margin improved as a result of increased productivity and cost reductions attributable to the conversion from 5-inch to 6-inch and 8-inch wafer manufacturing. Higher sales volumes and increased capacity utilization contributed to improved efficiencies and offset the adverse effect of pricing pressure on gross margin. In the 2005 financial year, gross margin deteriorated as a result of higher idle capacity costs in the first half of the financial year and strong pricing pressure, which could not be fully offset by productivity measures.

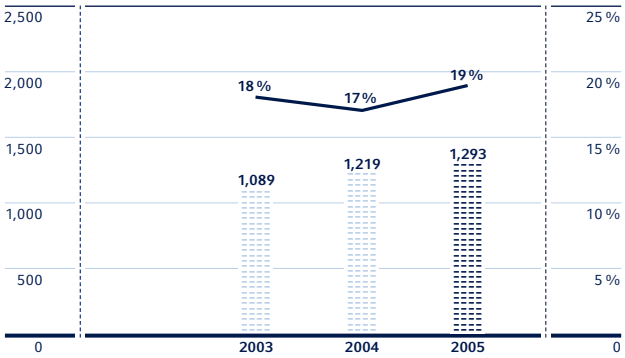
--- Communication

Gross margin for the 2004 financial year remained stable compared to the 2003 financial year, although it decreased from a high in the second quarter. This decrease resulted principally from a continuing price decline experienced in access products. Gross margin deteriorated in the 2005 financial year mainly due to increased idle capacity costs.

--- Memory Products

Gross margin improved during the 2004 financial year mainly due to improved productivity and reduced manufacturing costs as a result of the conversion to 140 and 110- nanometer process technologies and 300-millimeter production efficiencies. These more than offset the effects of lower average selling prices and led to a significant increase in gross margin in the second half of the 2004 financial year. The gross margin impact in the 2004 financial year of lower license income was partially offset by reduced depreciation expense attributable to governmental grants. Gross margin decreased in the 2005 financial year, as the improvements of productivity and reduced manufacturing costs resulting from the 110-nanometer process technology conversion and the increasing share of 300-millimeter manufacturing could not compensate for the effect of lower average selling prices and the unfavorable U.S. dollar/euro exchange rate.

R&D expenses € in millions
and as percentage of net sales in %



Focus on the development of advanced back-end technologies and products with high growth and profitability potential.

Research and development (R&D) expenses

Research and development expenses consist primarily of salaries and fringe benefits for research and development personnel, materials costs, depreciation and maintenance of equipment used in our research and development efforts, and contracted technology development costs. Materials costs include expenses for development wafers and costs relating to pilot production activities prior to the commencement of commercial production. R&D expenses also include our joint technology development arrangements with partners such as Nanya and IBM.

We continue to focus our investments on the development of leading-edge manufacturing technologies and products with high potential for growth and profitability.

For the years ended September 30	2003	2004	2005
Research and development expenses € in millions	1,089	1,219	**1,293**
Changes year-on-year		12 %	**6 %**
% of net sales	18 %	17 %	**19 %**
In-process R&D charges € in millions	6	9	**0**
% of net sales	0 %	0 %	**0 %**
Government subsidies € in millions	59	74	**50**
% of net sales	1 %	1 %	**1 %**

In-process R&D charges relate primarily to the acquisition of SensoNor in the 2003 financial year and ADMtek Inc., Hsinchu, Taiwan ("ADMtek") in the 2004 financial year. In the 2005 financial year we had no acquisitions that resulted in in-process R&D charges. Each charge is unique to the acquisition and depends on a variety of factors such as the stage of technology development and the anticipated future use at the acquisition date.

Some of our R&D projects qualify for subsidies from local and regional governments where we do business. If the criteria to receive a grant are met, the subsidies received reduce R&D expenses over the project term as expenses are incurred.

--- Automotive, Industrial and Multimarket

During the 2004 financial year, R&D expenses increased in absolute terms and remained constant as a percentage of sales, as a result of increased R&D spending in the fields of microcontrollers and automotive applications. R&D expenses increased slightly both in absolute terms and as a percentage of sales in the 2005 financial year. The increase took place mainly in the automotive and power business.

Communication

R&D expenses increased in the 2004 financial year in absolute terms and remained relatively stable as a percentage of sales. This increase was mainly the result of in-process R&D charges in connection with the ADMtek acquisition and additional R&D expenses resulting from our intensified focus on software and solutions activities and third-generation mobile phone semiconductors. R&D expenses in the 2005 financial year remained relatively stable in absolute terms and increased relative to sales compared to the 2004 financial year. The high level of R&D expenses was maintained in the first half of the 2005 financial year, with a focus on software and solution activities for third-generation mobile phone semiconductors as well as for broadband semiconductor solutions. In the second half of the 2005 financial year, R&D expenses were reduced in absolute terms, reflecting the successful implementation of efficiency programs initiated in the second quarter of the 2005 financial year.

Memory Products

In the 2004 financial year, R&D expenses increased in absolute terms, although they remained constant relative to sales, reflecting in particular the development of commodity DRAM and flash technologies, which were not entirely offset by the benefits of the joint development of DRAM technologies with Nanya. In the 2005 financial year, R&D expenses increased in absolute terms due to increased spending on the acceleration of the development of next generation memory technologies and the broadening of the overall memory portfolio.

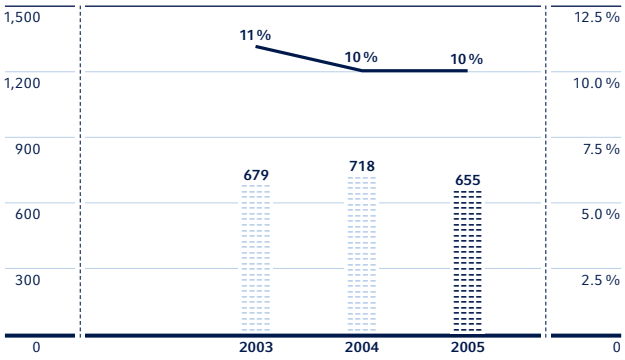
Selling, General, and Administrative (SG&A) expenses

Selling expenses consist primarily of salaries and fringe benefits for personnel engaged in sales and marketing activities, costs of customer samples, costs related to prototyping activities, other marketing incentives, and related marketing expenses.

General and administrative expenses consist primarily of salaries and benefits for administrative personnel, non-manufacturing-related overhead costs, consultancy, legal and other fees for professional services, and recruitment and training expenses.

For the years ended September 30	2003	2004	2005
Selling, general, and administrative expenses € in millions	679	718	**655**
Changes year-on-year		6 %	**(9 %)**
% of net sales	11 %	10 %	**10 %**

SG&A expenses € in millions
and as percentage of net sales in %



Reductions in SG&A expenses as a result of cost-saving measures across the Company.

The slight decline of selling, general, and administrative expenses as a percentage of net sales in the 2004 financial year was mainly due to our sales increasing at a faster rate than our expenditures. During the 2005 financial year, despite the significant increase in sales volume, we were able to reduce selling, general, and administrative expenses in absolute terms as a result of cost reduction measures, particularly in central service providers and information technology (IT).

Selling expenses increased in absolute terms during the 2004 financial year, due to increased sales and higher-volume business as well as expansion in the Asia-Pacific region, partially offset by sales and marketing cost-reduction programs in our Communication and Automotive, Industrial and Multimarket segments. Selling expenses decreased in absolute terms during the 2005 financial year following the decrease in net sales.

The increase in general and administrative expenses during the 2004 financial year was mainly attributable to higher IT expenditures, professional fees, and expenses associated with expanding our presence in the USA and Asia, and was partially offset by savings from our cost-reduction programs. In the 2005 financial year, general and administrative expenses decreased due to general cost-saving measures throughout the Company.

Other items affecting earnings

For the years ended September 30	2003	2004	2005
Restructuring charges € in millions	29	17	**78**
% of net sales	0 %	0 %	**1 %**
Other operating expense, net € in millions	85	257	**92**
% of net sales	1 %	4 %	**1 %**
Equity in (losses) earnings of associated companies € in millions	18	(14)	**57**
% of net sales	0 %	(0 %)	**1 %**
Other non-operating (expense) income, net € in millions	21	(64)	**26**
% of net sales	0 %	(1 %)	**0 %**

Restructuring charges

In the 2003 financial year we accrued charges for severance payments to eliminate excess overhead. In connection with our decision to close down various development centers in the 2004 financial year, we recorded restructuring charges, mainly for severance payments. In the 2005 financial year, we continued our restructuring and cost-saving efforts aimed at reducing costs, including downsizing our workforce and consolidating certain functions and operations. We agreed upon plans to terminate employees, primarily in connection with the closedown of fiber optics operations in Germany and the United States, as well as measures taken to restructure our chip manufacturing in the front-end area within the manufacturing cluster Perlach, Regensburg, and Villach. Production activities at Munich-Perlach will be transferred principally to Regensburg and, to a lesser extent, to Villach.

Other operating expense, net

Other operating expense, net, in the 2004 financial year related principally to charges from our settlement of an antitrust investigation by the U.S. Department of Justice, related settlements with customers, and a similar ongoing investigation in Europe, as well as a goodwill impairment charge of €71 million related to our 2001 acquisition of Catamaran. In the 2005 financial year, other operating expense included a net charge of €96 million resulting primarily from the reorganization of certain communication businesses and goodwill and other intangible assets impairment charges.

Equity in (losses) earnings of associated companies

Our principal associated companies are ALTIS, Inotera (since the 2003 financial year) and ProMOS (through part of the 2003 financial year). Both ProMOS and Inotera are DRAM manufacturers and our equity in their earnings has been sensitive to fluctuations in the price of DRAM and is reflected in the results of the Memory Products segment.

In the 2003 financial year, the recovery in DRAM prices resulted in improved earnings at ProMOS prior to our withdrawal from the venture. Start-up losses at Inotera during the ramp-up phase of production contributed to the losses incurred in the 2004 financial year. In the 2005 financial year, Inotera contributed the majority of our equity in earnings from associated companies, reflecting the start of volume production by that joint venture.

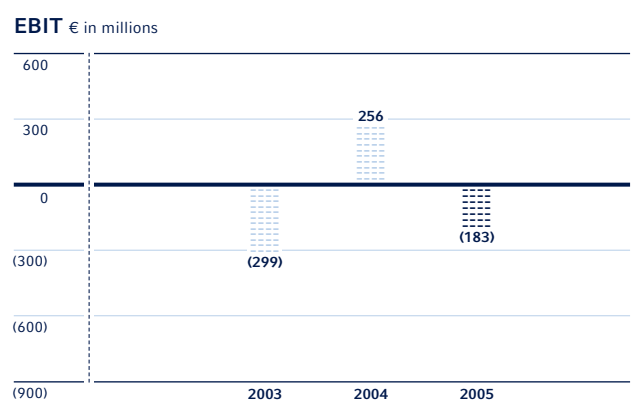
Other non-operating (expense) income, net

Other non-operating income and expense can consist of various items from period to period not directly related to our principal operations, including gains and losses on sales of marketable securities. Other non-operating expense, net, in the 2004 financial year mainly consisted of €65 million of investment-related impairment charges. In the 2005 financial year, other non-operating income, net, included €40 million related to net gains from foreign currency derivatives and foreign currency transactions and a gain of €13 million realized on the sale of our venture capital activities, partially offset by investment-related impairment charges of €29 million.

Earnings before interest and taxes (EBIT)

We define EBIT as earnings (loss) before interest and taxes. Our management uses EBIT as a measure to establish budgets and operational goals, to manage our business and to evaluate its performance. We report EBIT information because we believe that it provides investors with meaningful information about our operating performance and especially about the performance of our separate operating segments. EBIT is determined from the consolidated statements of operations as follows:

For the years ended Sep. 30 € in millions	2003	2004	2005
Net income (loss)	(435)	61	**(312)**
Add: Income tax expense	84	154	**120**
Interest expense, net	52	41	**9**
EBIT	(299)	256	**(183)**



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

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

Automotive, Industrial and Multimarket

The EBIT improvement in the 2004 financial year was mainly due to higher sales volumes and improved manufacturing efficiency, partially offset by continued pricing pressure. The EBIT decline in the 2005 financial year resulted primarily from the deterioration of the gross margin. As part of that, EBIT was negatively impacted by costs related to product transfers in connection with the planned phase-out of production at Munich-Perlach and costs incurred in connection with our new production site in Kulim, Malaysia.

Communication

The EBIT loss decreased in the 2004 financial year, primarily due to lower operating costs, which were partially offset by losses associated with the acquisition of ADMtek. EBIT for the 2004 financial year included goodwill impairments of €71 million related to our Catamaran acquisition. The EBIT decrease in the 2005 financial year resulted mainly from charges in connection with the reorganization of certain communication businesses and impairment charges aggregating €96 million, as well as a decline in gross margin.

Memory Products

The EBIT improvement in the 2004 financial year was primarily due to increased sales volumes and productivity improvements, which offset the impact of the weak U.S. dollar/euro exchange rate, lower license income and antitrust related charges. The EBIT decline in the 2005 financial year resulted primarily from a decline of average selling prices for DRAM products and the weak U.S. dollar/euro exchange rate, as well as the increase in R&D expenses resulting from the acceleration of our technology development and the broadening of our product portfolio, which could not be entirely offset by productivity improvements and increasing license revenue.

The EBIT amounts of our separate reporting segments were as follows[1]:

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

1 Amounts in prior periods have been conformed to the current year presentation.

Other Operating Segments

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

Corporate and Reconciliation

The EBIT loss decreased in the 2004 financial year, principally reflecting reduced idle-capacity costs resulting from improved utilization. The EBIT deterioration in the 2005 financial year resulted primarily from restructuring charges of €78 million in connection with the planned phase-out of production at our Munich-Perlach facility and the restructuring of our fiber optics business.

Interest expense, net

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

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

Interest expense in the 2003, 2004, and 2005 financial years relates principally to the convertible bonds that we issued in February 2002 and in June 2003. In addition, interest expense in the 2004 financial year included €21 million, paid upon redemption of the other investors' ownership interests in the Infineon Technologies SC300 GmbH & Co. OHG ("SC300") venture in Dresden. These effects were partially reduced in the 2004 and 2005 financial years as a result of the redemption of a portion of our convertible bonds in 2004 and increased interest capitalization related to facilities under construction, as well as interest income from financial derivatives.

Income taxes

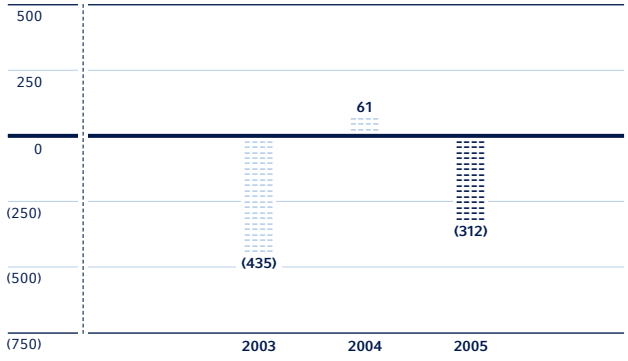
For the years ended September 30	2003	2004	2005
Income tax expense € in millions	(84)	(154)	**(120)**
% of net sales	(1%)	(2%)	**(2%)**
Effective tax rate	(24%)	72%	**(63%)**

Pursuant to U.S. GAAP, deferred tax assets in tax jurisdictions that have a three-year cumulative loss are subject to a valuation allowance excluding the impact of forecasted future taxable income. In the 2003 financial year we recorded an increase to the valuation allowance of €182 million, which limited the net tax benefit recognized, because we had incurred a cumulative loss in certain tax jurisdictions over the three-year period ended September 30, 2003; however, we continued to record tax expense in profitable tax jurisdictions. In the 2004 financial year, our effective tax rate increased because we recorded additional valuation allowances of €54 million related to tax jurisdictions that continue to have a three-year cumulative loss, and also had more non-deductible expenditures. In the 2005 financial year, as in the 2004 financial year, we continued to have a three-year cumulative loss in certain tax jurisdictions and we recorded an increase to the valuation allowance of €192 million. We assess our deferred tax asset position on a regular basis. Our ability to realize benefits from our deferred tax assets is dependent on our ability to generate future taxable income sufficient to utilize tax loss carry-forwards or tax credits before expiration. We expect to continue to recognize no tax benefits in these jurisdictions until we have ceased to be in a cumulative loss position for the preceding three-year period.

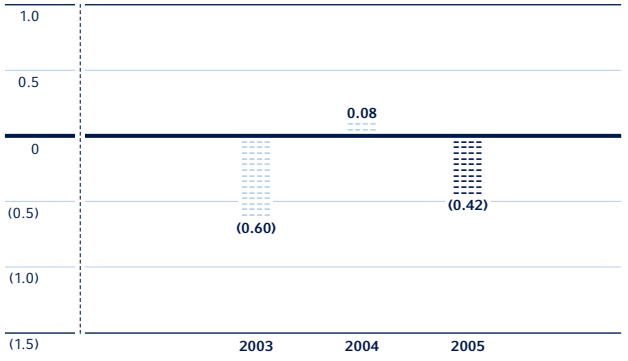
Net income (loss)

Net loss decreased significantly in the 2003 financial year principally as a result of sales volume growth and manufacturing efficiencies and cost reduction efforts. This trend continued in the 2004 financial year, resulting in the achievement of profitability, although the impact was reduced through the increased charges for impairments, antitrust-related matters and tax expense. In the 2005 financial year, the net loss incurred resulted primarily from the combination of lower revenues and gross margin, long-term asset impairments, restructuring measures and tax expense.

Net income (loss) € in millions



Earnings (loss) per share in €



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

FINANCIAL CONDITION

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

As of September 30, 2005, our total assets decreased slightly in comparison to the prior year. Total current assets decreased at the end of the 2005 financial year primarily due to the repayment of a €450 million loan entered into in connection with the build-out of our plant in Dresden.

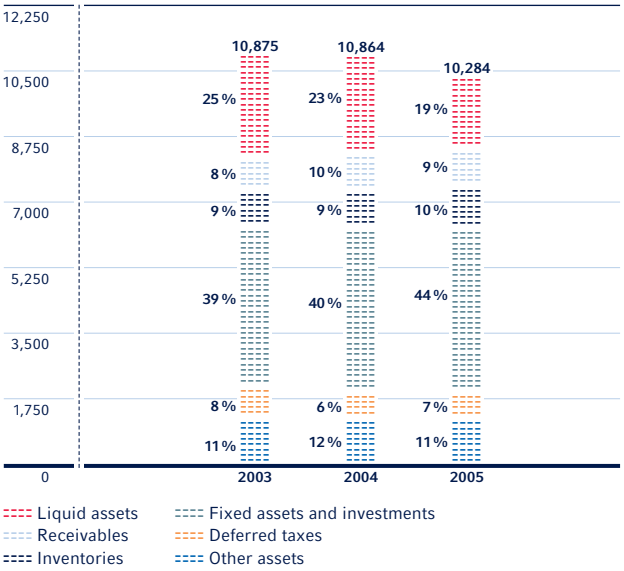
Non-current assets increased slightly at the end of the 2005 financial year as depreciation, amortization and impairment charges mostly offset capital expenditures and investments in associated companies during the year.

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

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

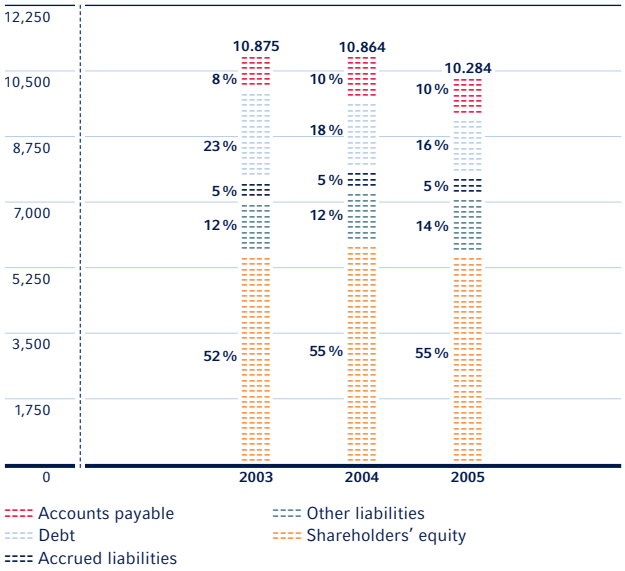
The equity return amounted to negative 5 percent and the return on assets amounted to negative 3 percent in the 2005 financial year, compared to positive 1 percent for both financial ratios in the 2004 financial year. The equity-to-fixed-assets ratio decreased to 150 percent in the 2005 financial year from 167 percent in the prior year as a result of the net loss and capital expenditures which exceeded depreciation expense during the year. The decrease of the debt-to-equity ratio to 30 percent, compared to 33 percent in the 2004 financial year, was mainly attributable to the repayment of the €450 million loan entered into in connection with the build-out of our plant in Dresden during the 2005 financial year.

Assets € in millions



Liquid assets decreased due to the repayment of debt.

Liabilities and equity € in millions



Debt decreased due to the redemption of a loan.

LIQUIDITY

Cash flow

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

Our consolidated statement of cash flows shows the sources and uses of cash during the reported periods. It is of key importance for the evaluation of our financial position.

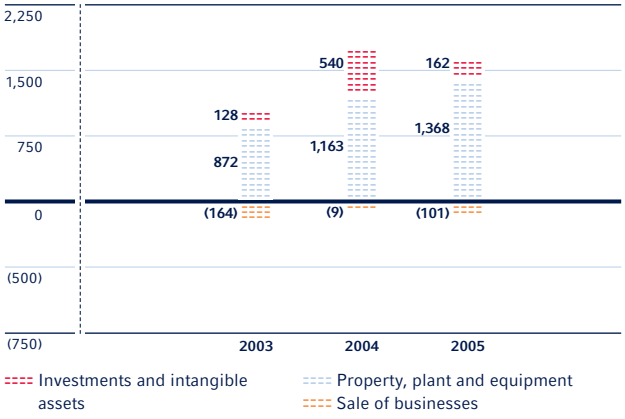
Cash flows from investing and financing activities are both indirectly determined based on payments and receipts. Cash flows from operating activities are determined indirectly from net income (loss). The changes in balance sheet items have been adjusted for the effects of foreign currency exchange fluctuations and for changes in the scope of consolidation. Therefore, they do not conform to the corresponding changes in the respective balance sheet line items.

Cash provided by operating activities in the 2005 financial year resulted mainly from the net loss of €312 million, which is net of non-cash charges for depreciation of €1,316 million, impairment charges of €134 million, and deferred income taxes of €88 million. Cash provided by operating activities was positively impacted by a decrease of trade accounts receivable of €119 million. These effects were partly offset by a decrease in accrued liabilities and trade accounts payable of €166 million.

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

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

Investments/Dispositions[1] € in millions



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

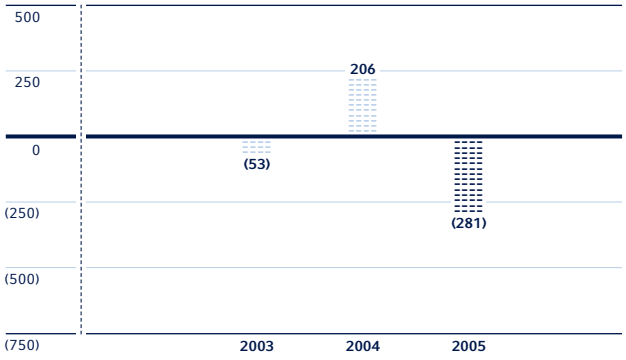
Free cash flow

We define free cash flow as cash from operating and investing activities excluding purchases or sales of marketable securities. Since we hold a substantial portion of our available monetary resources in the form of readily available marketable securities, and operate in a capital-intensive industry, we report free cash flow to provide investors with a measure that can be used to evaluate changes in liquidity after taking capital expenditures into account. It is not intended to represent the residual cash flow available for discretionary expenditures, since debt service

requirements or other non-discretionary expenditures are not deducted. The free cash flow is determined as follows from the consolidated statements of cash flows:

For the years ended Sep. 30 € in millions	2003	2004	2005
Net cash provided by operating activities – total	730	1,857	**1,039**
Net cash used in investing activities	(1,522)	(1,809)	**(238)**
Purchases (sale) of marketable securities, net	739	158	**(1,082)**
Free cash flow	(53)	206	**(281)**

Free cash flow € in millions



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

Net cash position

The following table presents our gross and net cash positions and the maturity of debt. It is not intended to be a forecast of cash available in future periods.

Our gross cash position – representing cash and cash equivalents, plus marketable securities – decreased to €2,006 million at September 30, 2005, compared with €2,546 million at the prior year end. The decrease was principally due to the repayment of a €450 million loan entered into in connection with the build-out of our plant in Dresden.

Long-term debt principally consists of convertible notes that were issued in order to strengthen our liquidity position and allow us more financial flexibility in conducting our business operations. The total outstanding convertible notes as of September 30, 2005, amounted to €1,340 million.

On June 5, 2003, we issued €700 million in subordinated convertible notes due 2010 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 68.4 million ordinary shares of our Company, at a conversion price of €10.23 per share through maturity.

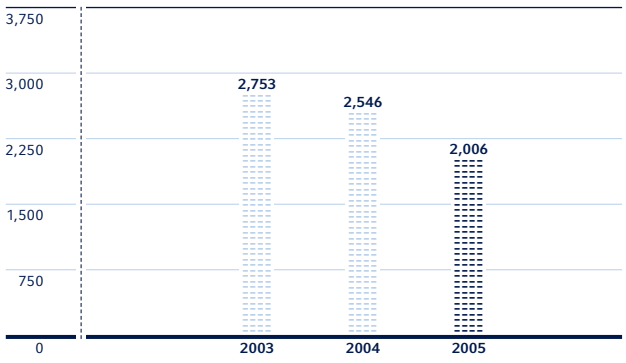
On February 6, 2002, we issued €1,000 million in subordinated convertible notes due 2007 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 28.2 million of our Company's ordinary shares at a conversion price of €35.43 per share through maturity. During the 2004 financial year we redeemed €360 million of our convertible notes due 2007. As of September 30, 2005, the outstanding amount was €640 million.

Our net cash position – meaning cash and cash equivalents, plus marketable securities, less total financial debt – decreased by €207 million to €341 million at September 30, 2005, compared with €548 million at September 30, 2004, principally as a result of negative free cash flow of €281 million.

To secure our cash position and to keep flexibility with regards to liquidity, we have implemented a policy with risk limits for the amounts deposited with respect to the counterparty, credit rating, sector, duration, credit support, and type of instrument.

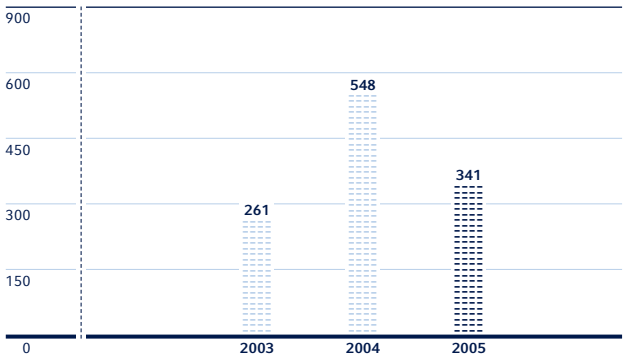
As of September 30, 2005 € in millions, payments due by period:	Total	Less than 1 year	1–2 years	2–3 years	3–4 years	4–5 years	After 5 years
Cash and cash equivalents	**1,148**	1,148	–	–	–	–	–
Marketable securities	**858**	858	–	–	–	–	–
Gross cash position	**2,006**	2,006	–	–	–	–	–
Less:							
Long-term debt	**1,566**	–	650	51	64	733	68
Short-term debt and current maturities	**99**	99	–	–	–	–	–
Total financial debt	**1,665**	99	650	51	64	733	68
Net cash position	**341**	1,907	(650)	(51)	(64)	(733)	(68)

Gross cash position € in millions



Gross cash position decreased due to the repayment of debt.

Net cash position € in millions



Net cash position decreased as a result of the net loss.

Capital requirements

We require capital in our 2006 financial year to:
--- finance our operations;
--- make scheduled debt payments;
--- settle contingencies if they occur; and
--- make planned capital expenditures.

We can meet these requirements through:
--- cash flow generated from operations;
--- cash on hand and securities we can sell; and
--- available credit facilities.

As of September 30, 2005, we require funds for the 2006 financial year aggregating €1,618 million, consisting of €99 million for short-term debt payments and €1,519 million for commitments. In addition, we may need up to €166 million for currently known contingencies. We also plan to invest up to an additional €700 million in capital expenditures that have not been otherwise committed. The aggregate capital required for such commitments, contingencies, and planned capital expenditures during the 2006 financial year is €2,484 million as of September 30, 2005. We have a gross cash position of €2,006 million as of September 30, 2005, and also the ability to draw funds from available credit facilities of €1,149 million.

As of September 30, 2005, we had debt of €99 million scheduled to become due within one year.

Commitments and contingencies

As of September 30, 2005[1,2] € in millions, payments due by period:	Total	Less than 1 year	1–2 years	2–3 years	3–4 years	4–5 years	After 5 years
Contractual commitments:							
Operating lease payments	**850**	94	71	61	56	54	514
Unconditional purchase commitments	**1,505**	1,379	45	24	9	9	39
Other long-term commitments	**138**	46	46	46	–	–	–
Total commitments	**2,493**	1,519	162	131	65	63	553
Other contingencies:							
Guarantees	**462**	99	204	23	5	–	131
Contingent government grants[3]	**516**	67	101	128	42	55	123
Total contingencies	**978**	166	305	151	47	55	254

The above table should be read together with Note 31 to our consolidated financial statements for the year ended September 30, 2005.

1 Certain payments of obligations or expiration of commitments that are based on the achievement of milestones or other events that are not date-certain are included for purposes of this table, based on our estimate of the reasonably likely timing of payments or expirations in each particular case. Actual outcomes could differ from those estimates.

2 Product purchase commitments associated with capacity reservation agreements are not included in this table, since the purchase prices are based, in part, on future market prices, and are accordingly not quantifiable at September 30, 2005. Purchases under these agreements aggregated approximately €950 million for the year ended September 30, 2005.

3 Contingent government grants refer to amounts previously received, related to the construction and financing of certain production facilities, which are not guaranteed otherwise and could be refundable if the total project requirements are not met.

Capital expenditures

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

Depending on our business situation we expect to invest between €1.2 billion and €1.4 billion in capital expenditures in the 2006 financial year, largely for our manufacturing facilities in Richmond, Virginia, and Kulim, Malaysia. We are also constantly improving productivity and upgrading technology at existing facilities, especially in Dresden, Germany. As of September 30, 2005, approximately €650 million of this amount has been committed and included in unconditional purchase commitments. Due to the lead times between ordering and delivery of equipment, a substantial amount of capital expenditures typically is committed well in advance. Approximately 50 percent of these expected capital expenditures will be made in the Memory Products segment's front-end and back-end facilities.

Credit facilities

We have established both short and long-term credit facilities with a number of different financial institutions in order to meet our anticipated funding requirements. These facilities, which aggregate €1,491 million, of which €1,149 million remained available at September 30, 2005, comprise the following:

Credit facilities € in millions

			As of September 30, 2005		
Term	Nature of financial institution commitment	Purpose/intended use	Aggregate facility	Drawn	Available
short-term	firm commitment	working capital, guarantees	120	51	69
short-term	no firm commitment	working capital, cash management	305	–	305
long-term	firm commitment	working capital	731	–	731
long-term[1]	firm commitment	project finance	335	291	44
Total			1,491	342	1,149

1 Including current maturities.

In September 2004 we executed a $400/€400 million syndicated credit facility with a five-year term. The facility consists of two tranches: Tranche A is a $400 million term loan intended to finance the expansion of our Richmond, Virginia, manufacturing facility. Tranche B is a €400 million multicurrency revolving facility to be used for general corporate purposes. The maximum outstanding amount of Tranche A will decrease on the basis of a repayment schedule that foresees equal installments starting from September 30, 2006. The facility has customary financial covenants, and drawings bear interest at market-related rates that are linked to financial performance. The lenders of this credit facility have been granted a negative pledge relating to our future financial indebtedness with certain permitted encumbrances. At September 30, 2005, no amounts were outstanding under this facility.

A €124 million non-recourse project financing facility for the expansion of the Porto, Portugal, manufacturing facility was executed in May 2005. As of September 30, 2005, €80 million has been drawn under this facility.

At September 30, 2005, we were in compliance with our debt covenants under the relevant facilities.

We plan to fund our working capital and capital requirements from cash provided by operations, available funds, bank loans, government subsidies and, if needed, the issuance of additional debt or equity securities. We have also applied for governmental subsidies in connection with certain capital expenditure projects, but can provide no assurance that such subsidies will be granted on a timely basis or at all. We can provide no assurance that we will be able to obtain additional financing for our research and development, working capital, or investment requirements or that any such financing, if available, will be on terms favorable to us.

Taking into consideration the financial resources available to us, including our internally generated funds and currently available banking facilities, we believe that we will be in a position to fund our capital requirements in the 2006 financial year.

Pension plan funding

Our Company's projected benefit obligation, which considers future compensation increases, amounted to €477 million at September 30, 2005, compared to €349 million at September 30, 2004. The fair value of plan assets as of September 30, 2005, was €243 million, compared to €204 million as of September 30, 2004.

We have estimated the return on plan assets for the next financial year to be 6.5 percent or €14 million for domestic plans and 6.7 percent or €2 million for foreign plans. The actual return on plan assets between the last measurement dates amounted to 10.9 percent or €19 million for domestic plans and 6.7 percent or €2 million for foreign plans, compared to the expected return on plan assets for that period of 7.3 percent for domestic plans and 6.9 percent for foreign plans.

At September 30, 2004 and 2005, the combined funding status of our pension plans reflected an underfunding of €145 million and €234 million, respectively. The Company expects that contributions to its pension plans during the year ending September 30, 2006, would significantly exceed the level of contributions made during the year ended September 30, 2005.

Our investment approach with respect to the pension plans involves employing a sufficient level of flexibility to capture investment opportunities as they occur, while maintaining reasonable parameters to ensure that prudence and care are exercised in the execution of the investment program. The pension plans' assets are invested with several investment managers. The plans employ a mix of active and passive investment management programs. Considering the duration of the underlying liabilities, a portfolio of investments of plan assets in equity securities, debt securities, and other assets is targeted to maximize the long-term return on plan assets for a given level of risk. Investment risk is monitored on an ongoing basis through periodic portfolio reviews, meetings with investment managers and liability measurements. Investment policies and strategies are periodically reviewed to ensure the objectives of the plans are met considering any changes in benefit plan design, market conditions, or other material items.

Our asset allocation targets for pension plan assets are based on our assessment of business and financial conditions, demographic and actuarial data, funding characteristics, related risk factors, market sensitivity analyses and other relevant factors. The overall allocation is expected to help protect the plans' level of funding while generating sufficiently stable real returns (i.e., net of inflation) to meet current and future benefit payment needs. Due to active portfolio management, the asset allocation may differ from the target allocation up to certain limits. As a matter of policy, our pension plans do not invest in our Company shares.

EMPLOYEES AND CAMPEON

Employees

The following table indicates the composition of our workforce by function and region at the end of the financial years indicated.

As of September 30	2003	2004	2005
Function:			
Production	22,405	24,540	**25,114**
Research & Development	5,935	7,160	**7,401**
Sales & Marketing	2,048	1,948	**2,016**
Administrative	1,920	1,922	**1,909**
Total	32,308	35,570	**36,440**
Region:			
Germany	16,166	16,387	**16,119**
Europe	5,034	5,631	**5,482**
North America	2,757	2,982	**3,193**
Asia-Pacific	8,116	10,340	**11,451**
Japan	118	133	**158**
Other	117	97	**37**
Total	32,308	35,570	**36,440**

Employees by function[1]

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

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

Campeon

We entered into a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG ("MoTo") to lease an office complex constructed by MoTo south of Munich, Germany. The office complex, called Campeon, will enable us to centralize most of our Munich-area employees, who are currently situated in various locations throughout Munich, in one central physical working environment. MoTo was responsible for the construction, which was completed in the second half of 2005. We have no obligations with respect to financing MoTo, and have provided no guarantees related to the construction. We occupied Campeon under an operating lease arrangement in October 2005, and have begun the gradual move of our employees to this new location.

RISKS AND OPPORTUNITIES

Introduction

Like no other business, the semiconductor industry is characterized by periods of growth which are historically followed by periods of market contraction. Such periods of market contraction are characterized by surplus capacity, order cancellations as well as price erosion and sales volume reductions. The risks associated with the cyclical nature of this business are compounded by the need for large scale capital investments in order to achieve and sustain market leadership as well as the sector's rapid pace of technological change. These risks are, however, often accompanied by substantially greater opportunities.

Infineon risk management system

Given the volatility of the business cycle in the semiconductor industry it is very important that the risk and opportunity management policies are geared towards the goal of resilient profitable growth. The ability to quickly react to changing market developments is therefore crucial. To this end we have established a risk and opportunity management system which allows us to exploit the many significant opportunities manifesting themselves in our markets and to anticipate and identify risks associating or arising from them. An enterprise-wide system of risk and opportunity reporting is a central element of our risk and opportunity management system. The scope and depth of reporting helps to enable corporate management to take quick and effective actions whenever situations so require. Within every organizational unit of the Company, risk officers or risk reporters have been designated to implement and execute the risk and opportunity reporting process. According to the guide-

lines for this process, risks and opportunities are identified within the framework of a risk and opportunity categorization model, accompanied by an evaluation of each risk and opportunity based on its respective probability and effect upon EBIT. The risk management system is extensively documented in our intranet and thus accessible by our employees worldwide.

The reporting system is based upon individual observations of risk and opportunity and is composed of a range of monitoring and management processes embedded in our core processes. It commences at the level of strategic planning and continues through the manufacturing and sales operations, including the processing of receivables. As an extension of the forecasting processes conducted by the business groups, the sales organization, the manufacturing clusters and the central functions, the risk and opportunity system is used to identify and evaluate possible deviations from expected developments. Beyond the identification and evaluation of major developments that may impact the business, the system is also used to prioritize and implement activities to enhance opportunities and mitigate or reduce our risk.

Risk and opportunity reports are issued on a regular basis by all of our business units. These reports form the core of the risk management system. The reports are examined and evaluated by the Management Board and business group management as part of their reviewing process.

Alongside the enterprise-wide reporting system, we have established a quantitative risk analysis process for our manufacturing and research and development activities in order to provide greater transparency of risks and prioritize measures designed to enhance the probabilities of success of these activities. Furthermore, this quantitative risk analysis methodology is being applied to financial decision-making processes, in particular to investment decisions and forecasting processes. The goal of employing this methodology is to ensure that appropriate risk mitigation and opportunity enhancement strategies are chosen and implemented.

The systematic development of existing systems of risk analysis and the creation of new early warning systems substantially contribute to the enhancement and sustainability of a risk and opportunity culture within the Company. This is supported by regular Risk & Opportunity Forum meetings involving the risk officers of the Company. These meetings provide a communication platform for exchanging ideas and information on risk analysis and risk management; they furthermore provide a basis for the creation of awareness of this important subject matter throughout the Company.

In the course of an annual Risk Management System Analysis ("RMSA") our Business Groups and Central Functions are called upon to review the effectiveness and efficiency of the key elements of the Infineon Risk and Opportunity Management System. This is executed via self-assessment using a questionnaire which is crafted to facilitate improvements and support the audit process, both by our internal and external auditors.

Our risk and opportunity reporting system has been evaluated by the external auditors as part of the annual audit process. The external auditors have confirmed that the Management Board has fulfilled its obligation according to paragraph 91 subsection 2 of the German Law on Stock Companies ("Aktiengesetz"), which calls for the creation of a reporting system which enables management to receive early warning of developments which may endanger the existence of the Company as a whole.

Global business risks

Substantial changes in regional business environments around the globe may have adverse affects on our business and results of operations.

Our global business strategy implies that we maintain research and development locations as well as manufacturing sites in many countries around the world. This may be the result of strategic decisions to enhance our cost competitiveness, overcome market entry hurdles or enhance opportunities related to technology development. More than half of our sales volume is generated outside of Europe. With the expected growth rates of Asian countries in the near future we expect our investments to increase in this region. Therefore risks could develop based upon:

- negative economic developments in foreign economies and instability of foreign governments, including the threat of war or civil unrest;
- changes in laws and policies affecting trade and investment; and
- varying practices of the regulatory, tax, judicial and administrative bodies in the jurisdictions where we operate.

Substantial changes in any of these conditions could have an adverse affect on our business and results of operations. It cannot be excluded that regional crises like the SARS epidemic in 2003 will not have any negative effects on our business or profitability. However, broad diversification within our product portfolio and the spread of development and manufacturing locations around the world provide an effective approach to mitigate the overall risk of such regional crises as the dependencies are generally reduced.

Risks related to our operations

From our Memory Product segment the volatility of DRAM-memory prices remains the most important risk but also the most prominent opportunity both for this segment as well as for the Company as a whole. In the past financial year the market price of our main product, the 256 Mbit DDR SDRAM varied between U.S. $4.82 and U.S. $2.25 (source: DRAM Exchange, 256 M DDR 400 average). Through our entry into the market for flash memory products we are expanding our product portfolio which carries both opportunities but also substantial risks. These risks are compounded by the strong position of our competitors in particular in terms of market share and technological capabilities. In relation to the previous financial year we also see substantial manufacturing risks as we are currently ramping the newest 90-nanometer manufacturing technology at a number of our production sites. Within the Logic segments of our business, Automotive, Industrial and Multimarket as well as Communication we see comparatively less volatility than in the Memory Products segment but nonetheless substantial volume risks. The quick pace of technological change coupled with the possibility of delays in the introduction of new products in the market can have a significant effect on our production volumes which may in turn influence the relationships with our major customers. Price pressure for individual products within the competitive market environment may further influence our margins in these business segments. As a substantial volume of our products may be purchased by a select number of customers, our operational results may also be dependant upon their success in the marketplace. Developments in the market which are not within our sphere of influence, such as the sale of the mobile phone unit of Siemens AG to BenQ, may also have negative effects on our potential business volume.

In order to address the risks relating to the quality of our products we have established continuous quality improvement initiatives within the product development, manufacturing and logistic processes. Our quality management system (which includes the deliveries of our suppliers) has been certified on a worldwide basis according to ISO 9001/TS 16949 for a number of years.

We have procured insurance coverages to limit the impact of losses, incidents or certain other events posing possible perils and threats to our assets, finances or earnings.

In the area of intellectual property, the Company has signed a number of cross-license agreements with other companies. The Company is working intensively to increase the number and scope of such cross-license agreements with other companies in order to reduce the risk of claims for patent infringement.

Tax, fair trade and stock exchange regulations can all supply a basis for additional risks. To mitigate the cause and effect of these risks we rely upon the counsel of professionals, including both the advice of our own employees as well as the advice of independent service providers.

Market risks

Exchange rate risks

Our involvement and participation in various regional markets around the world creates cash flows in a number of different currencies – primarily in U.S. dollars. Since we are exposed to fluctuating currencies and substantial volatility relating to exchange rates, the management of these risks becomes an important issue.

A major portion of our sales volumes as well as the costs relating to the design, production and manufacturing of products are based in U.S. dollars, not in euros. Exchange rate fluctuations may have substantial effects on our sales, our costs and our overall results of operations.

Our policy with respect to limiting short-term foreign currency exposure generally is to economically hedge at least 75 percent of our estimated net exposure for a minimum period of two months in advance and, depending on the nature of the underlying transactions, a significant portion for the periods thereafter. Parts of our foreign currency exposure cannot be mitigated due to differences between actual and forecasted amounts. We calculate this net exposure on a cash flow basis considering actual orders received or made and all other planned revenues and expenses.

Interest rate risk management

We are exposed to interest rate risk through our debt instruments, fixed term deposits and loans. During the 2002 and 2003 financial years, we issued two convertible bonds. Due to the high volatility of our core business and to maintain high operational flexibility, our current assets are kept at a high level. These assets are mainly deposited in instruments with short term interest rates. To reduce the risk caused by changes in the market interest rates, the duration of the interest rates of our debts and current assets are aligned by the use of interest rate derivatives.

Commodity price risk

We are exposed to commodity price risks with respect to raw materials used in the manufacture of our products. We seek to minimize the risks through our sourcing policies and operating procedures. We do not utilize derivative financial instruments to manage any remaining exposure to fluctuations in commodity prices.

Financing risks

Semiconductor companies that operate their own manufacturing facilities require significant amounts of capital to build, expand, modernize and maintain them. Semiconductor companies also require significant amounts of capital to fund research and development. These capital requirements should generally be financed by incoming cash flow, the use of available credit lines, available public funding for projects and – depending upon market conditions – capital market offerings. Although we have applied for financial support from public authorities on a number of projects, we may not be able to guarantee that we will be able to raise the amount of capital required for our business from these sources in a timely and successful fashion. We intend to continue the policy of cooperation with other semiconductor companies to share the costs of research and development as well as to create joint production facilities.

Legal risks

As this applies to many companies within the semiconductor industry, Infineon has been exposed to patent claims, claims relating to alleged defective or faulty products, claims relating to the alleged transgression of environmental rules or regulations and other general liability claims. Regardless of the outcome of these claims, the company may sustain substantial costs in defending itself against these claims. Infineon intends to exert substantial efforts in defending itself against unfounded claims including the support of internal and external experts.

Reorganization of our Memory Products segment

The proposed reorganization of our Memory Products segment – and any follow-up steps we may take – may impose unexpected burdens on our business and may not produce the benefits we expect.

In November 2005 our Supervisory Board approved a plan to restructure our Company in order to better prepare us to exploit market opportunities for our memory and logic businesses as and when they arise. The first step in this process will be a transfer of all of the assets and liabilities of our Memory Products segment into a separate, wholly owned subsidiary of Infineon (this ''drop-down'' of assets and liabilities, or "Teilbetrieb", is known as an "Ausgliederung" under German law). We expect that the transfer of the assets and liabilities of our Memory Products segment into a separate, wholly owned subsidiary of Infineon, will be completed by June 2006. We intend to monitor and evaluate financial and industry developments continuously during the 2006 financial year, and will consider further reorganization steps as appropriate.

The drop-down of the memory products business may be more difficult or expensive than we anticipate, and may require greater management time and other resources than expected, any of which could adversely affect our business or results of operations. These transactions will be extremely complex, and we may not be successful in executing them in the most efficient and cost-effective manner. In addition, any additional steps we may take following this initial reorganization may prove not to be the most strategically advantageous options available to us. This reorganization and related follow-up steps, if any, could adversely impact both our memory and our logic businesses. In any event, we may not realize all the benefits for each of our business lines that we intend to realize from these transactions.

Overall risks

At no time during the past financial year have we been aware of any substantial risks which would have threatened the existence of the Company. Risks which may endanger the existence of the Company are currently not visible.

Additional descriptions relating to risks may be found in the notes to the consolidated financial statements included in this report as well as in the "Annual Report on Form 20-F".

INFINEON TECHNOLOGIES AG

Infineon Technologies AG is the parent company of the Infineon Group and carries out the Group's management and corporate functions. Infineon Technologies AG has major group-wide responsibilities such as finance and accounting, human resources, strategic and product-oriented research and development activities, as well as worldwide corporate and marketing communications. The responsibility for managing the flows of supplies, products, and services among the group companies is also handled by Infineon Technologies AG. Infineon Technologies AG has its own production facilities in Munich and Regensburg.

Infineon Technologies AG prepares its financial statements on a standalone basis in accordance with the requirements of the German commercial code (HGB). The complete financial statements are published separately.

Statements of operations[1] (condensed) € in millions

As of September 30	2003	2004	2005
Net sales	8,122	8,852	**9,038**
Cost of goods sold	(7,201)	(7,325)	**(8,045)**
Gross profit	921	1,527	**993**
Operating expenses	(1,460)	(1,533)	**(1,483)**
Other income	252	136	**155**
Income (loss) before tax	(287)	130	**(335)**
Income tax	0	0	**(2)**
Net (loss) income	(287)	130	**(337)**
Accumulated loss brought forward	(1,052)	(1,339)	**(1,209)**
Accumulated loss at end of year	(1,339)	(1,209)	**(1,546)**

1 Prepared in accordance with German GAAP (HGB).

During the financial year ended September 30, 2005, net sales decreased in the communications business group. In the memory products business group, net sales increased significantly. Sales in the 2005 financial year were also positively impacted by an increase in license income. Net loss for the year resulted in part from an increase in cost of sales and stronger price competition. Infineon Technologies AG handles the settlement of accounts for and with its subsidiaries that produce and sell products. As a result, Infineon Technologies AG's sales and cost of sales on a standalone basis were higher than those of the Infineon Group as a whole.

Net loss for the year was impacted by extraordinary allowances (€160 million) on investments and intellectual property, recorded pursuant to § 253 Abs. 2 S. 3 HGB, by credit notes for prior years from Infineon Technologies Dresden GmbH & Co. OHG, Dresden (€82 million), and by collection of prior year's net income (€98 million) from Infineon Technologies SC 300 GmbH & Co. KG, Dresden.

Balance sheets[1] (condensed) € in millions

As of September 30	2004	2005
Fixed and intangible assets	768	**718**
Investments	5,733	**6,182**
Non-current assets	6,501	**6,900**
Inventories	470	**463**
Receivables and other assets	1,992	**1,908**
Cash and marketable securities	2,395	**1,886**
Current assets	4,857	**4,257**
Total assets	11,358	**11,157**
Shareholders' equity	7,182	**6,845**
Accrued liabilities	798	**846**
Payables and other liabilities	3,378	**3,466**
Total liabilities and shareholders' equity	11,358	**11,157**

1 Prepared in accordance with German GAAP (HGB).

Infineon Technologies AG's financial position showed an increase in investments, and a decrease in cash and marketable securities which was principally caused by our investments in SensoNor ASA, Infineon Technologies Finance GmbH and Inotera, partially offset by a capital decrease at Infineon Technologies Holding B.V., The Netherlands. The decrease in cash stems from operative business. The reduction in shareholders' equity results from the net loss for the year ended September 30, 2005. Infineon Technologies AG's shareholders' equity ratio was 61 percent (2003: 63 percent).

Dividend

The standalone financial statements of Infineon Technologies AG, prepared in accordance with the HGB requirements for the 2004 financial year showed a net loss, therefore no dividend was distributed. A net loss was also incurred for the 2005 financial year and therefore a dividend cannot be distributed.

Merger EUPEC

Effective October 1, 2005, EUPEC Europäische Gesellschaft für Leistungshalbleiter mbH, Warstein-Belecke was merged with Infineon Technologies AG, Munich.

SUBSEQUENT EVENTS

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

OUTLOOK

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

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

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

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

- In our Automotive, Industrial and Multimarket segment, we expect revenues and EBIT to increase slightly in the automotive and industrial business in the first quarter of the 2006 financial year compared to the fourth quarter of the 2005 financial year, despite annual price reductions at major customers that take effect for the first time in the first quarter of the 2006 financial year. We anticipate revenues and EBIT in the security and chip-card business to remain under pressure, but expect the trend to reverse beginning with the second quarter of the 2006 financial year, due to the cost reduction measures put in place. In the overall Automotive, Industrial and Multimarket segment, we expect revenues to increase slightly and EBIT margin to remain stable compared to the fourth quarter of the 2005 financial year, despite the mentioned price reductions, the anticipated expenses in connection with the planned phase-out of production at Munich-Perlach, and expenses for the new production site in Kulim, Malaysia.
- In the first quarter of the 2006 financial year, we expect revenues in our Communication segment to remain stable compared to the fourth quarter of the 2005 financial year. We anticipate the segment's EBIT loss to stay in the range of the EBIT loss in the fourth quarter of the 2005 financial year.
- In our Memory Products segment, we expect seasonal strength in demand for computers to drive bit-growth in the DRAM market in the first quarter of the 2006 financial year. On the supply side, capacity and productivity in the industry are expected to grow, offset only partially by capacity shifts to non-DRAM products by some of our competitors. This, coupled with pricing pressure and uncertainties regarding chipset availability in the PC segment, makes price development difficult to predict. We expect to further grow our bit production based on additional capacities at our joint venture Inotera and our 300-millimeter production facility in Richmond. We continue to focus our portfolio on higher margin growth businesses, including infrastructure, and high-end graphics, as well as consumer and mobile applications.

Report of independent Registered Public Accounting Firm

The Supervisory Board of Infineon Technologies AG

We have audited the accompanying consolidated balance sheets of Infineon Technologies AG and subsidiaries as of September 30, 2004 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 30, 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 Infineon Technologies AG and subsidiaries as of September 30, 2004 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2005, in conformity with U.S. generally accepted accounting principles.

Munich, Germany
October 31, 2005, except for Note 33, which is as of November 17, 2005

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Hoyos
Wirtschaftsprüfer

Feege
Wirtschaftsprüfer

Consolidated financial statements

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

	Notes	2003	2004	2005
Net sales:				
Third parties	5	5,153	6,169	**5,843**
Related parties	27	999	1,026	**916**
Total net sales		6,152	7,195	**6,759**
Cost of goods sold	7	4,614	4,670	**4,909**
Gross profit		1,538	2,525	**1,850**
Research and development expenses		1,089	1,219	**1,293**
Selling, general, and administrative expenses		679	718	**655**
Restructuring charges	8	29	17	**78**
Other operating expenses, net	7	85	257	**92**
Operating (loss) income		(344)	314	**(268)**
Interest expense, net		(52)	(41)	**(9)**
Equity in earnings (losses) of associated companies	16	18	(14)	**57**
Gain (loss) on associated company share issuance	16	(2)	2	**–**
Other non-operating income (expense), net		21	(64)	**26**
Minority interests		8	18	**2**
Income (loss) before income taxes		(351)	215	**(192)**
Income tax expense	9	(84)	(154)	**(120)**
Net (loss) income		(435)	61	**(312)**
Basic and diluted (loss) earnings per share in €	10	(0.60)	0.08	**(0.42)**

See accompanying notes to the consolidated financial statements.

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

	Notes	2004	2005
Assets:			
Current assets:			
Cash and cash equivalents		608	**1,148**
Marketable securities	11	1,938	**858**
Trade accounts receivable, net	12	1,056	**952**
Inventories	13	960	**1,022**
Deferred income taxes	9	140	**125**
Other current assets	14	590	**469**
Total current assets		5,292	**4,574**
Property, plant and equipment, net	15	3,587	**3,751**
Long-term investments, net	16	708	**779**
Restricted cash		109	**88**
Deferred income taxes	9	541	**550**
Other assets	17	627	**542**
Total assets		10,864	**10,284**
Liabilities and shareholders' equity:			
Current liabilities:			
Short-term debt and current maturities	21	571	**99**
Trade accounts payable	18	1,098	**1,069**
Accrued liabilities	19	555	**497**
Deferred income taxes	9	16	**17**
Other current liabilities	20	630	**700**
Total current liabilities		2,870	**2,382**
Long-term debt	21	1,427	**1,566**
Deferred income taxes	9	21	**65**
Other liabilities	22	568	**642**
Total liabilities		4,886	**4,655**
Shareholders' equity:			
Ordinary share capital	23	1,495	**1,495**
Additional paid-in capital		5,800	**5,800**
Accumulated deficit		(1,200)	**(1,512)**
Accumulated other comprehensive loss	25	(117)	**(154)**
Total shareholders' equity		5,978	**5,629**
Total liabilities and shareholders' equity		10,864	**10,284**

See accompanying notes to the consolidated financial statements.

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

	Notes	Issued Ordinary shares in shares	Issued Ordinary shares amount	
Balance as of October 1, 2002		720,784,218	1,442	
Net loss		–	–	
Other comprehensive (loss) income	25	–	–	
Total comprehensive loss				
Issuance of ordinary shares:				
Acquisition of Catamaran		96,386	–	
Deferred compensation, net		–	–	
Other equity transactions		–	–	
Balance as of September 30, 2003		720,880,604	1,442	
Net income		–	–	
Other comprehensive (loss) income	25	–	–	
Total comprehensive income				
Issuance of ordinary shares:				
Settlement of redeemable interest		26,679,255	53	
Deferred compensation, net		–	–	
Balance as of September 30, 2004		747,559,859	1,495	
Net loss		–	–	
Other comprehensive income (loss)	25	–	–	
Total comprehensive loss				
Issuance of ordinary shares:				
Exercise of stock options	24	9,500	–	
Balance as of September 30, 2005		747,569,359	1,495	

See accompanying notes to the consolidated financial statements.

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

(euro in millions, except where otherwise stated)

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

	Notes	2003	2004	2005
Net income (loss)		(435)	61	**–312**
Adjustments to reconcile net income (loss) to cash provided by operating activities:				
Depreciation and amortization	15/17	1,437	1,320	**1,316**
Acquired in-process research and development	3	6	9	**–**
Deferred compensation		7	2	**–**
Provision for (recovery of) doubtful accounts	12	(16)	15	**3**
Gain on sale of marketable securities	11	(56)	(9)	**(8)**
Loss (gain) on sale of businesses	4	10	2	**(39)**
Loss (gain) on disposal of property, plant and equipment		3	(5)	**(8)**
Equity in (earnings) losses of associated companies	16	(18)	14	**(57)**
Loss (gain) on associated company share issuance	16	2	(2)	**–**
Minority interests		(8)	(18)	**(2)**
Impairment charges	16/17	98	136	**134**
Deferred income taxes	9	16	96	**88**
Changes in operating assets and liabilities:				
Trade accounts receivable	12	(227)	(219)	**119**
Inventories	13	(112)	(40)	**(25)**
Other current assets	14	156	154	**(2)**
Trade accounts payable	18	(217)	228	**(52)**
Accrued liabilities	19	164	92	**(114)**
Other current liabilities	20	(17)	(22)	**–**
Other assets and liabilities	17/22	(62)	43	**(2)**
Net cash provided by operating activities		731	1,857	**1,039**

See accompanying notes to the consolidated financial statements.

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

	Notes	2003	2004	2005
Cash flows from investing activities:				
Purchases of marketable securities available for sale		(2,752)	(2,678)	**(2,228)**
Proceeds from sale of marketable securities available for sale		2,013	2,520	**3,310**
Proceeds from sale of businesses		164	9	**101**
Business interests, net of cash acquired		6	(29)	**–**
Investment in associated and Related Companies	16	(76)	(386)	**(135)**
Dividends received from equity investments		–	–	**51**
Purchases of intangible assets	17	(58)	(125)	**(27)**
Purchases of property, plant and equipment	15	(872)	(1,163)	**(1,368)**
Proceeds from sales of property, plant and equipment	15	53	43	**58**
Net cash used in investing activities		(1,522)	(1,809)	**(238)**
Cash flows from financing activities:				
Net change in short-term debt	21	(36)	62	**(20)**
Net change in related party financial receivables and payables	27	(76)	75	**18**
Proceeds from issuance of long-term debt	21	700	–	**192**
Principal repayments of long-term debt	21	(25)	(549)	**(500)**
Change in restricted cash		3	(43)	**21**
Proceeds from issuance of shares to minority interest		–	53	**23**
Net cash provided by (used in) financing activities		566	(402)	**(266)**
Effect of foreign exchange rate changes on cash and cash equivalents		(4)	(7)	**5**
Net increase (decrease) in cash and cash equivalents		(229)	(361)	**540**
Net decrease in cash and cash equivalents from discontinued operation		(1)	–	**–**
Cash and cash equivalents at beginning of year		1,199	969	**608**
Cash and cash equivalents at end of year		969	608	**1,148**

See accompanying notes to the consolidated financial statements.

Notes to the consolidated financial statements

1 DESCRIPTION OF BUSINESS, FORMATION, AND BASIS OF PRESENTATION

Description of business

Infineon Technologies AG and its subsidiaries (collectively, the "Company") design, develop, manufacture, and market a broad range of semiconductors and complete systems solutions used in a wide variety of microelectronic applications, including computer systems, telecommunications systems, consumer goods, automotive products, industrial automation and control systems, and chip card applications. The Company's products include standard commodity components, full-custom devices, semi-custom devices, and application-specific components for memory, analog, digital, and mixed-signal applications. The Company has operations, investments, and customers located mainly in Europe, Asia, and North America. The financial year-end for the Company is September 30.

Formation

Infineon Technologies AG was formed as a legal entity as of April 1, 1999 (the "Formation"), through the contribution by Siemens Aktiengesellschaft ("Siemens") of substantially all of its semiconductor-related investments, operations, and activities. The Company had its initial public offering ("IPO") on March 13, 2000, is listed on the New York Stock Exchange, and is one of the DAX 30 companies on the Frankfurt Stock Exchange.

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Infineon Technologies AG is incorporated in Germany. The German Commercial Code ("Handelsgesetzbuch" or "HGB") requires the Company to prepare consolidated financial statements in accordance with the HGB accounting principles and regulations ("German GAAP"). Pursuant to the transitional regulation of the German Bilanzrechtsreformgesetz Article 58, paragraph 3 EGHGB, the Company is exempt from this requirement, if consolidated financial statements are prepared and issued in accordance with a body of internationally accepted accounting principles (such as U.S. GAAP). Accordingly, the Company presents the U.S. GAAP consolidated financial statements contained herein.

All amounts herein are shown in millions of euros (or "€") except where otherwise stated.

Certain amounts in prior year consolidated financial statements and notes have been reclassified to conform to the current year presentation. Results of operations have not been affected by these reclassifications.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of the accompanying consolidated financial statements.

Basis of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its significant subsidiaries on a consolidated basis. Investments in companies in which the Company has an ownership interest of 20% or more but which are not controlled by the Company ("Associated Companies") are accounted for using the equity method of accounting (see note 16). The equity in earnings of Associated Companies with different financial year ends is principally recorded on a three-month lag. Other equity investments ("Related Companies"), in which the Company has an ownership interest of less than 20%, are recorded at cost. The effects of all significant intercompany transactions are eliminated.

The Company group consists of the following numbers of entities in addition to the Company:

	Consolidated subsidiaries	Associated companies	Total
September 30, 2004	56	15	**71**
Additions	2	–	**2**
Disposals	(2)	(4)	**(6)**
September 30, 2005	56	11	**67**

Additionally, the Company has 31 (2004: 30) subsidiaries and 7 (2004: 9) Associated Companies that were accounted for under the equity method for each of the years ended September 30, 2004 and 2005, and under the cost method in prior years, as these companies are not material to the respective presentation of the financial position, results of operations or cash flows of the Company. The effect of not consolidating these companies

for the year ended September 30, 2003, on consolidated assets, revenues, and net income (loss) of the Company was less than 1%. For the years ended September 30, 2004 and 2005, not consolidating these companies had no effect on the Company's net income (loss), and impacted the Company's consolidated assets and revenues by less than 1%.

Reporting and foreign currency

The Company's reporting currency is the euro, and therefore the accompanying consolidated financial statements are presented in euros.

The assets and liabilities of foreign subsidiaries with functional currencies other than the euro are translated using period-end exchange rates, while the revenues and expenses of such subsidiaries are translated using average exchange rates during the period. Differences arising from the translation of assets and liabilities in comparison with the translation of the previous periods are included in other comprehensive income (loss) and reported as a separate component of shareholders' equity.

The exchange rates of the primary currencies used in the preparation of the accompanying consolidated financial statements are as follows:

Currency in €		Exchange rate September 30		Annual average exchange rate	
		2004	2005	2004	2005
U.S. dollar	1 $	0.8115	**0.8290**	0.8209	**0.7869**
Japanese yen	100 JPY	0.7320	**0.7357**	0.7545	**0.7331**
Great Britain pound	1 GBP	1.4667	**1.4650**	1.4704	**1.4507**
Singapore dollar	1 SGD	0.4793	**0.4911**	0.4808	**0.4749**

Revenue recognition

Sales

Revenue from products sold to customers is recognized, pursuant to SEC Staff Accounting Bulletin ("SAB") 104, "Revenue Recognition", when persuasive evidence of an arrangement exists, the price is fixed or determinable, shipment is made, and collectibility is reasonably assured. The Company records reductions to revenue for estimated product returns and allowances for discounts and price protection, based on actual historical experience, at the time the related revenue is recognized. In general, returns are permitted only for quality related reasons within the applicable warranty period, which is typically 12 months. Distributors can, in certain cases, apply for stock rotation or scrap allowances and price protection. Allowances for stock rotation returns are accrued based on expected stock rotation as per the contractual agreement. Distributor scrap allowances are accrued based on the contractual agreement and, upon authorization of the claim, reimbursed up to a certain maximum of the average inventory value. Price protection programs allow distributors to apply for a price protection credit on unsold inventory in the event the Company reduces the standard list price of the products included in such inventory. In some cases, rebate programs are offered to specific customers whereby the customer may apply for a rebate upon achievement of a defined sales volume. Distributors are also partially compensated for commonly defined cooperative advertising on a case-by-case basis.

License income

License income is recognized when earned and realizable (see note 5). Lump sum payments are generally non-refundable and are deferred where applicable and recognized over the period in which the Company is obliged to provide additional service. Pursuant to Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", revenues from contracts with multiple elements entered into after July 1, 2003, are recognized as each element is earned based on the relative fair value of each element and when there are no undelivered elements that are essential to the functionality of the delivered elements and when the amount is not contingent upon delivery of the undelivered elements. Royalties are recognized as earned.

Grants

Grants for capital expenditures include both tax-free government grants (Investitionszulage) and taxable grants for investments in property, plant and equipment (Investitionszuschüsse). Grants receivable are established when a legal right for the grant exists and the criteria for receiving the grant have been

(euro in millions, except where otherwise stated)

met. Tax-free government grants are deferred (see note 22) and recognized over the remaining useful life of the related asset. Taxable grants are deducted from the acquisition costs of the related asset (see note 6) and thereby reduce depreciation expense in future periods. Other taxable grants reduce the related expense (see notes 6, 20, and 22).

Product-related expenses

Shipping and handling costs associated with product sales are included in cost of sales. Expenditures for advertising, sales promotion and other sales-related activities are expensed as incurred. Provisions for estimated costs related to product warranties are generally made at the time the related sale is recorded, based on estimated failure rates and claim history. Research and development costs are expensed as incurred.

Income taxes

Income taxes are accounted for under the asset and liability method pursuant to Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes". 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. Investment tax credits are accounted for under the flow-through method.

Stock-based compensation

The Company accounts for stock-based compensation using the intrinsic value method pursuant to Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees", and recognizes compensation cost over the pro rata vesting period. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123" (see note 24).

Issuance of shares by subsidiaries or Associated Companies

Gains or losses arising from the issuances of shares by subsidiaries or Associated Companies, due to changes in the Company's proportionate share of the value of the issuer's equity, are recognized in earnings pursuant to SAB Topic 5:H, "Accounting for Sales of Stock by a Subsidiary" (see note 16).

Cash and cash equivalents

Cash and cash equivalents represent cash, deposits, and liquid short-term investments with original maturities of three months or less. Cash equivalents as of September 30, 2004 and 2005, were €541 and €1,093, respectively, and consisted mainly of bank term deposits and fixed income securities with original maturities of three months or less.

Restricted cash

Restricted cash includes collateral deposits used as security under arrangements for deferred compensation, business acquisitions, construction projects, leases, and financing (see notes 31).

Marketable securities

The Company's marketable securities are classified as available-for-sale and are stated at fair value as determined by the most recently traded price of each security at the balance sheet date. Unrealized gains and losses are included in accumulated other comprehensive income, net of applicable income taxes. Realized gains or losses and declines in value, if any, judged to be other-than-temporary on available-for-sale securities, are reported in other non-operating income or expense. For the purpose of determining realized gains and losses, the cost of securities sold is based on specific identification.

Inventories

Inventories are valued at the lower of cost or market, cost being generally determined on the basis of an average method. Cost consists of purchased component costs and manufacturing costs, which comprise direct material and labor costs and applicable indirect costs.

Property, plant and equipment

Property, plant and equipment is valued at cost less accumulated depreciation. Spare parts, maintenance, and repairs are expensed as incurred. Depreciation expense is recognized using the straight-line method. Construction in progress includes advance payments for construction of fixed assets. Land and construction in progress are not depreciated. The cost of construction of certain long-term assets includes capitalized interest, which is amortized over the estimated useful life of the related asset. During the years ended September 30, 2004 and 2005, capitalized interest was €9 and €9, respectively. The estimated useful lives of assets are as follows:

	Years
Buildings	10–25
Technical equipment and machinery	3–10
Other plant and office equipment	1–10

Leases

The Company is a lessee of property, plant and equipment. All leases where the Company is lessee that meet certain specified criteria intended to represent situations where the substantive risks and rewards of ownership have been transferred to the lessee are accounted for as capital leases pursuant to SFAS No. 13, "Accounting for Leases", and related interpretations. All other leases are accounted for as operating leases.

Intangible assets

The Company accounts for business combinations using the purchase method of accounting pursuant to SFAS No. 141, "Business Combinations". Intangible assets acquired in a purchase method business combination are recognized and reported apart from goodwill, pursuant to the criteria specified by SFAS No. 141.

Intangible assets consist primarily of purchased intangible assets, such as licenses and purchased technology, which are recorded at acquisition cost, and goodwill resulting from business acquisitions, representing the excess of purchase price over fair value of net assets acquired. Intangible assets other than goodwill are amortized on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 10 years. Pursuant to SFAS No. 142 "Goodwill and Other Intangible Assets", goodwill is not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. The Company tests goodwill annually for impairment in the fourth quarter of the financial year, whereby if the carrying amount of a reporting unit with goodwill exceeds its fair value, the amount of impairment is determined by the excess of recorded goodwill over the fair value of goodwill. The determination of fair value of the reporting units and related goodwill requires considerable judgment by management.

Impairment of long-lived assets

The Company reviews long-lived assets, including property, plant and equipment and intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Estimated fair value is generally based on either appraised value or measured by discounted estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows.

Long-term investments

The Company assesses declines in the value of investments accounted for under the equity and cost methods to determine whether such decline is other-than-temporary, thereby rendering the investment impaired. This assessment is made by considering available evidence including changes in general market conditions, specific industry and individual company data, the length of time, and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the individual company, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

(euro in millions, except where otherwise stated)

Financial instruments

The Company operates internationally, giving rise to exposure to changes in foreign currency exchange rates. The Company uses financial instruments, including derivatives such as foreign currency forward and option contracts as well as interest rate swap agreements, to reduce this exposure based on the net exposure to the respective currency. The Company applies SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 137, SFAS No. 138, and SFAS No. 149, which provides guidance on accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Derivative financial instruments are recorded at their fair value and included in other current assets or other current liabilities. Generally the Company does not designate its derivative instruments as hedge transactions. Changes in fair value of undesignated derivatives that relate to operations are recorded as part of cost of sales, while undesignated derivatives relating to financing activities are recorded in other non-operating expense. Changes in fair value of derivatives designated as fair value hedges and the related hedged items are reflected in earnings. Changes in the fair value of derivatives designated as cash flow hedges are, to the extent effective, deferred in accumulated other comprehensive income and subsequently reclassified to earnings when the hedging transaction is reflected in earnings and, to the extent ineffective, included in earnings immediately. The fair value of derivative and other financial instruments is discussed in note 29.

Pension plans

In December 2003, the FASB issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements Nos. 87, 88, and 106", which revises employers' disclosures about pension plans and other postretirement benefit plans. SFAS No. 132 (revised 2003) requires additional disclosures to those in the original SFAS No. 132, which it replaces. During the year ended September 30, 2004, the Company adopted SFAS No. 132 (revised 2003) with disclosures provided in note 28.

Use of estimates

The preparation of the accompanying financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent amounts and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual amounts could differ materially from such estimates made by management.

Recent accounting pronouncements

In June 2004, EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments", was issued which includes new guidance for evaluating and recording other-than-temporary impairment losses on debt and equity securities accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" and cost method investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. While the disclosure requirements for specified debt and equity securities and cost method investments were effective for annual periods ending after December 15, 2003, the FASB has directed the FASB staff to delay the effective date for the measurement and recognition guidance contained in EITF Issue No. 03-1. This delay does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. The Company does not expect the adoption of EITF Issue No. 03-1 to have a significant impact on its consolidated financial position or results of operations.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – an amendment of ARB No. 43, Chapter 4", which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), requiring that such costs be recognized as current period charges and requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. SFAS No. 151 is effective for the Company's financial year beginning October 1, 2005. The Company does not expect the implementation of SFAS No. 151 to have a significant impact on its consolidated financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets – an Amendment of APB Opinion No. 29", which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The Company adopted SFAS No. 153 for nonmonetary asset exchanges occurring on or after July 1, 2005. The adoption SFAS No. 153 did not have a significant impact on the Company's consolidated financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) "Share-Based Payments". SFAS No. 123 (revised 2004) requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognize the cost over the period during which an employee is required to provide service in exchange for the award. SFAS No. 123 (revised 2004) eliminates the alternative method of accounting for employee share-based payments previously available under APB No. 25. The Securities and Exchange Commission issued guidance on April 14, 2005, announcing that public companies will be required to adopt SFAS No. 123 (revised 2004) by their first financial year beginning after June 15, 2005. Accordingly, the Company will adopt SFAS No. 123 (revised 2004) in the first quarter of the 2006 financial year. The adoption of SFAS No. 123 (revised 2004) is not expected to have a significant effect on the Company's consolidated financial position or cash flows but is expected to have an adverse effect on its results of operations, the exact amount of which is not currently determinable.

3 ACQUISITIONS

The Company established the Infineon Technologies Flash joint venture (then called "Ingentix") in which the Company initially held a 51% ownership interest with Saifun Semiconductors Ltd. ("Saifun") in April 2001. In the 2003 financial year, the Company increased its ownership interest to 70% by contributing additional capital and converting existing shareholder loans to equity. The joint venture operated through two companies, Infineon Technologies Flash GmbH & Co. KG, located in Dresden, Germany, and Infineon Technologies Flash Ltd., located in Netanya, Israel. During December 2004, Saifun and the Company modified their cooperation agreement. As a consequence, the Company consummated the acquisition of Saifun's remaining 30% share in the Infineon Technologies Flash joint venture in January 2005 and was granted a license for the use of Saifun NROM® technologies, in exchange for $95 million to be paid in quarterly installments over 10 years and additional purchase consideration primarily in the form of net liabilities assumed aggregating €7 (see note 5). The assets acquired and liabilities assumed were recorded in the accompanying consolidated balance sheet based upon their estimated fair values as of the date of the acquisition. The excess of the purchase price over the estimated fair values of the underlying assets acquired and liabilities assumed amounted to €7 and was allocated to goodwill. The preliminary purchase price allocation may be adjusted within one year of the purchase date for changes in estimates of the fair value of assets acquired and liabilities assumed. The Company has sole ownership and responsibility for the business and started to account for its entire financial results in the second quarter of the 2005 financial year (see note 21).

On April 30, 2004, the Company completed its acquisition of 100% of ADMtek Inc., Hsinchu, Taiwan ("ADMtek") in exchange for €75 in cash (of which €6 is held in escrow subject to the accuracy of the seller's representations and warranties). Payment of an additional €28, held in escrow and reflected as restricted cash, is contingent upon employee retention and the achievement of certain performance and development milestones over a two-year period, and is to be recognized as the milestones are achieved. As of September 30, 2005, €8 has been paid to ADMtek and €13 was released to the Company since certain performance and development milestones were not achieved. Accordingly, the remaining balance held in escrow amounted to €13 as of September 30, 2005. This acquisition was designed to enable access to the home gateway systems market for the wireline communications business.

The Company acquired 92.5% of the outstanding shares of SensoNor AS ("SensoNor") on June 18, 2003, following a public tender offer, and acquired the remaining 7.5% by June 30, 2003, for total cash consideration of €34. In addition, the Company contributed capital of €13 in connection with the consummation of the transaction. SensoNor develops, produces, and markets tire pressure and acceleration sensors. With this acquisition the Company aimed to strengthen its position in semiconductor sensors for the automotive business. During the year ended September 30, 2004, following the restructuring of the SensoNor business, the Company recorded a purchase accounting adjustment reducing the previously established deferred tax asset valuation allowance by €8 and decreasing goodwill

correspondingly. During the year ended September 30, 2005, the Company increased its share capital of SensoNor and recorded a purchase accounting adjustment reducing the previously established deferred tax asset valuation allowance by €30 and decreasing goodwill and other intangible assets by €14 and €16, respectively.

On April 1, 2003, the Company completed the acquisition of the net assets of MorphICs Technology Inc. ("MorphICs"), a developer of digital baseband circuits of third generation wireless communications for €6 in cash. The acquisition agreement provided for the payment of contingent purchase consideration of €9 upon the achievement of specified events. As of September 30, 2005, €6 of contingent purchase consideration was forfeited since certain performance criteria were not achieved. The remaining contingent purchase consideration balance of €3 is subject to the achievement of certain performance criteria during the 2006 financial year.

On September 9, 2002, the Company acquired all of the shares of Ericsson Microelectronics AB ("MIC"). MIC, based in Sweden, is a supplier of Radio Frequency (RF) microelectronic components for wireless applications, high end power amplifiers, Bluetooth components, and broadband communications. MIC is a strategic supplier to Ericsson, a market leader in base stations, Bluetooth solutions, and RF components for mobile phones and wireless infrastructure. The Company also entered into a strategic supply agreement with Ericsson for a period of two years with certain specified purchase thresholds, pursuant to which €50 was recorded as a liability as of September 30, 2002.

In June 2003, the Company and Ericsson signed an amendment to the MIC acquisition agreement. The companies intended to strengthen their strategic cooperation in various areas of mobile phone technology and wireless infrastructure, including Bluetooth solutions, RF ICs, RF Power and other applications. Furthermore, the companies agreed to eliminate the remaining acquisition indebtedness, as well as the historic and future purchase thresholds of Ericsson and related penalties. In addition, the Company received €50 from Ericsson. These amounts were recorded as an adjustment, principally to the originally recorded goodwill, as well as to intangible assets and deferred taxes. Additionally, following the restructuring of the MIC business, the Company recorded a purchase accounting adjustment reversing the previously established deferred tax asset valuation allowance in the amount of €16 during the year ended September 30, 2003.

The following table summarizes the Company's acquisitions during the years ended September 30, 2003, 2004, and 2005:

	2003		2004	2005
	SensoNor	Other	ADMtek	Flash
Acquisition Date	June 2003	2003	April 2004	January 2005
Segment	Automotive, Industrial and Multimarket	Various	Communication	Memory Products
Cash	3	–	18	**1**
Other current assets	6	1	10	**16**
Property, plant and equipment	25	1	2	**4**
Intangible assets				
Current product technology	5	5	14	**–**
Core technology	–	–	5	**58**
Patents (Customer Relationship)	–	2	2	**–**
In process R&D	4	2	9	**–**
Goodwill	–	6	23	**7**
Other non-current assets	38	–	1	**3**
Total assets acquired	81	17	84	**89**
Current liabilities	(11)	(9)	(8)	**(45)**
Non-current liabilities (including debt)	(36)	–	(1)	**(2)**
Total liabilities assumed	(47)	(9)	(9)	**(47)**
Net assets acquired	34	8	75	**42**
Cash paid (Purchase Consideration)	34	8	75	**–**

The above acquisitions have been accounted for by the purchase method of accounting and, accordingly, the consolidated statements of operations include the results of the acquired companies from their respective acquisition dates.

For each significant acquisition the Company engaged an independent third party to assist in the valuation of net assets acquired. As a result of these valuations, amounts allocated to purchased in-process research and development of €6 and €9

(euro in millions, except where otherwise stated)

were expensed as research and development in the years ended September 30, 2003 and 2004, respectively, because the technological feasibility of products under development had not been established and no future alternative uses existed.

Pro forma financial information relating to these acquisitions is not material either individually or in the aggregate to the results of operations and financial position of the Company and has been omitted.

4 DISCONTINUED OPERATION AND DIVESTITURES

Discontinued operation

Pursuant to an agreement reached between the Company and OSRAM GmbH ("Osram"), the Company transitioned all of its opto-electronic activities to Osram as of March 31, 2003. The agreement provides for the transfer of all customer relationships and related backlog, the cancellation by the Company of all of its opto-electronic distribution agreements, as well as providing the Company with certain rights of return related to unsold inventory as of March 31, 2003. The Company did not incur a loss on the discontinuation of the opto-electronics business.

The following table presents comparative information of the discontinued operation, which was previously reported as part of the Other Operating Segments, for the year ended September 30, 2003:

	2003
Opto-electronics	
Sales:	
Third parties	113
Related parties	32
Net sales	145
Income (loss) from discontinued operation before tax	–
Income tax benefit (expense)	–
Net income (loss) from discontinued operation	–

The discontinued operation had no impact on the Company's results of operations and had no outstanding balances as of and for the years ended September 30, 2004 or 2005.

Divestitures

In August 2003, the Company sold its investment in UMCi and incurred a pre-tax loss on disposal of €9, which is reflected in other operating expense, net.

On July 1, 2002, the Company completed the sale of its gallium arsenide business, reflected in the Communication segment, including specified non-manufacturing tangible and intangible assets, as well as specified customer contracts and liabilities. The Company received initial cash proceeds of €50. Contingent purchase price adjustments were based on the level of gallium arsenide related product sales, at prices substantially below market, generated by the purchaser through September 30, 2004, and other adjustments. Contingent consideration adjustments were realized during the financial year ended September 30, 2004, which resulted in an obligation for the Company of €13 that was paid during the 2005 financial year.

On December 23, 2004, the Company agreed to sell its venture capital activities, reflected in the Other Operating Segments, to Cipio Partners, a venture capital company. Under the terms of the agreement, the Company sold its interest in Infineon Ventures GmbH including the majority of the venture investments held therein. The transaction closed on February 23, 2005. As a result of the sale, the Company realized a gain before tax of €13 which was recorded in other non-operating income.

On April 29, 2004, the Company entered into an agreement with Finisar Corporation ("Finisar") to sell the fiber optics business, reflected in the Communication segment. The agreement was amended on October 11, 2004, pursuant to which the Company would receive 110 million shares of Finisar's common stock in exchange for its fiber optics business and financial assistance with restructuring measures to be taken in future periods. The final number of Finisar shares that the Company would receive would have been subject to adjustment for changes in working capital of the fiber optics business. Additionally, the agreement contained a three-year non-compete clause and limited the aggregate indemnification liability to 20% of the consideration paid by Finisar. The purchase agreement would be terminated by mutual consent if the transaction were not to be consummated by March 31, 2005.

On January 11, 2005, the Company decided to terminate the agreement with Finisar dated October 11, 2004. On January 25, 2005, Finisar and the Company entered into a new agreement under which Finisar acquired certain assets of the Company's fiber optics business. Under the terms of the new agreement, the Company received 34 million shares of Finisar's common stock valued at €40 as consideration for the sale of inventory, fixed assets, and intellectual property associated with the design and manufacture of fiber optic transceivers. The Company also committed to provide Finisar with contract manufacturing services under separate supply agreements for up to one year following the closing. The transaction did not require shareholder or regulatory approval and closed on January 31,

(euro in millions, except where otherwise stated)

2005. As a result of the transaction, the Company realized a gain before tax of €21 which was recorded in other operating income.

On April 8, 2005, the Company sold to VantagePoint Venture Partners its entire share interest in Finisar's common stock. As a result of the sale, the Company recorded an other-than-temporary impairment of €8 in other non-operating expense during the second quarter of the 2005 financial year, to reduce the investment's carrying value to the net sale proceeds.

The Company retained ownership of its remaining fiber optics businesses consisting of bi-directional fiber transmission (BIDI) components for Fiber-To-The-Home (FTTH) applications, parallel optical components (PAROLI) and plastic optical fiber (POF) components that are used in automotive applications, which were reclassified from held for sale to held and used during the second quarter of the 2005 financial year, and were restructured. The reclassification of the retained fiber optic businesses into the held and used category was measured at the lower of their carrying amount before they were classified as held for sale, adjusted for depreciation expense that would have been recognized had the retained fiber optic businesses been continuously classified as held and used, or the fair value of the assets on January 25, 2005. Accordingly, the Company recognized an impairment charge of €34 in other operating expenses during the second quarter of the 2005 financial year.

On August 2, 2005, the Company sold the long-term assets utilized in the design and manufacture of BIDI components to EZConn Corporation ("EZConn") for cash consideration of €3. The Company also committed to provide EZConn with contract manufacturing services through March 2006. As a result of the transaction, the Company realized a gain before tax of €2, which was recorded in other operating income, and deferred €1 which will be realized over the term of the contract manufacturing agreement.

On April 7, 2005, the Company and Exar Corporation ("Exar") entered into an agreement whereby Exar acquired for $11 million cash a significant portion of the Company's optical networking business unit. The acquisition included assets relating to multi-rate TDM framer products, Fiber Channel over SONET/SDH, Resilent Packet Ring (RPR), as well as certain intellectual property for Data Over SONET products. As a result of the sale, the Company reclassified related non-current assets into assets held for sale during the second quarter of the 2005 financial year and reduced their carrying value to the net sale proceeds. The sale of the assets was consummated during the third quarter of the 2005 financial year.

Summary financial information for the divested businesses (through the date of divestiture) for the years ended September 30, 2003, 2004, and 2005, are as follows:

	2003	2004	2005
Sales:			
Gallium Arsenide	45	–	–
Fiber Optics	41	35	**23**
BIDI	7	10	**6**
Total	93	45	**29**
EBIT:			
Gallium Arsenide	5	–	–
UMCi	(11)	–	–
Infineon Ventures GmbH	(25)	(52)	**(3)**
Fiber Optics	(25)	(33)	**(27)**
BIDI	(9)	(28)	**(20)**
Total	(65)	(113)	**(50)**
Gain (loss) on sale before tax:			
Gallium Arsenide	–	–	–
UMCi	(9)	–	–
Infineon Ventures GmbH	–	–	**13**
Fiber Optics	–	–	**21**
BIDI	–	–	**2**
Other	(1)	(2)	**3**
Total (note 7)	(10)	(2)	**39**

5 LICENSES

During the years ended September 30, 2003, 2004, and 2005, the Company recognized revenues related to license and technology transfer fees of €183, €76, and €175, respectively, which are included in net sales in the accompanying statements of operations. Included in these amounts are previously deferred license fees of €135, €48, and €33, which were recognized as revenue pursuant to SAB 104, in the years ended September 30, 2003, 2004, and 2005, respectively, since the Company had fulfilled all of its obligations and all such amounts were realized.

In March 2000, the Company entered into technology transfer agreements with ProMOS Technologies Inc. ("ProMOS"), and restructured existing agreements with Mosel Vitelic Inc. ("MVI"), the majority shareholder of ProMOS. As part of these agreements, previously unrecognized license fees due from

(euro in millions, except where otherwise stated)

MVI were rescheduled and recognized as revenue over the life of the new contracts.

In February 2003, the Company, ProMOS, and MVI agreed to extinguish third party indebtedness of €60, which was subject to a guarantee by the Company, as well as offset other indebtedness between the parties. As a result, the Company recognized previously deferred license income of €60 related to this guaranteed indebtedness during the year ended September 30, 2003, since the amounts had been earned and realized.

Due to a revision of the technology transfer agreement between the Company and ProMOS, an additional €36 of previously deferred license income was recognized as revenue during the year ended September 30, 2003, as the Company had fulfilled its respective obligations.

On November 10, 2004, the Company and ProMOS reached an agreement regarding ProMOS' license of the Company's previously transferred technologies, pursuant to which ProMOS may continue to produce and sell products using those technologies and to develop its own processes and products. The Company has no continuing involvement with the licensing of these products to ProMOS. As full consideration, ProMOS agreed to pay the Company $156 million in four installments through April 30, 2006, against which the Company's accrued payable for DRAM products from ProMOS of $36 million was offset. The parties agreed to withdraw their respective claims, including arbitration. The present value of the settlement amounted to €118 and was recognized as license income during the first quarter of the 2005 financial year.

In connection with the joint technology development with Nanya Technology Corporation ("Nanya") (see note 16), in 2003 the Company granted Nanya a license to use its 110-nanometer technology in Nanya's existing operations. License income related to the technology is recognized over the estimated life of the technology.

In connection with the extension of a capacity reservation agreement with Winbond Electronics Corp., Hsinchu, Taiwan ("Winbond") in August 2004, the Company granted Winbond a license to use its 110-nanometer technology in Winbond's production process for the manufacture of products for the Company. The license income was deferred and is being recognized over the life of the capacity reservation agreement.

On March 18, 2005, the Company and Rambus Inc. ("Rambus") reached an agreement settling all claims between them and licensing the Rambus patent portfolio for use in current and future Company products. Rambus granted to the Company a worldwide license to existing and future Rambus patents and patent applications for use in the Company's memory products. In exchange for this worldwide license, the Company agreed to pay $50 million in quarterly installments of $6 million between November 15, 2005, and November 15, 2007. During the second quarter of the 2005 financial year, the Company recorded the license and corresponding liability in the amount of €37, representing the estimated present value of the minimum future license payments. After November 15, 2007, and only if Rambus enters into additional specified licensing agreements with certain other DRAM manufacturers, the Company would make additional quarterly payments which may aggregate a maximum of an additional $100 million. The agreement also provides the Company with an option for acquiring certain other licenses. All licenses provide for the Company to be treated as a "most-favored customer" of Rambus. The Company has simultaneously granted Rambus a fully-paid perpetual license for memory interfaces. In addition to the licenses, the two companies agreed to the dismissal of all pending litigation and released each other from all existing legal claims.

In connection with the acquisition of Saifun's remaining 30% share in the Infineon Technologies Flash joint venture during January 2005, the Company was granted a license for the use of Saifun NROM® technologies (see note 3). During the second quarter of the 2005 financial year, the Company recorded the license of €58 and a corresponding liability in the amount of €58, representing the estimated fair value of the license and minimum future license payments, respectively. The Company retained the option to terminate the entire license or parts thereof at any time without penalty. During the quarter ended June 30, 2005, the Company exercised its termination option and cancelled the portion of the license encompassing NROM® Code Flash products. As a result of the partial termination, the license asset and related liability were reduced to €28 and €29, respectively, as of June 30, 2005.

6 GRANTS

The Company has received economic development funding from various governmental entities, including grants for the construction of manufacturing facilities, as well as grants to subsidize research and development activities and employee training. Grants and subsidies included in the accompanying consolidated financial statements during the years ended September 30, 2003, 2004, and 2005, are as follows:

	2003	2004	2005
Included in the consolidated statements of operations:			
Research and development	59	74	**50**
Cost of sales	54	86	**121**
	113	160	**171**
Construction grants deducted from the cost of fixed assets	17	49	**–**
Deferred government grants (notes 20 and 22)	303	281	**288**

7 SUPPLEMENTAL OPERATING COST INFORMATION

The cost of services and materials are as follows for the years ended September 30:

	2003	2004	2005
Raw materials, supplies, and purchased goods	1,675	1,621	**1,867**
Purchased services	1,126	1,232	**1,166**
Total	2,801	2,853	**3,033**

Personnel expenses are as follows for the years ended September 30:

	2003	2004	2005
Wages and salaries	1,490	1,532	**1,664**
Social levies	268	280	**285**
Pension expense (note 28)	27	28	**28**
Total	1,785	1,840	**1,977**

Other operating expense, net, is as follows for the years ended September 30:

	2003	2004	2005
Gain (loss) from sale of businesses (note 4)	(10)	(2)	**39**
Goodwill and intangible assets impairment charges (note 17)	(68)	(71)	**(57)**
Long-lived asset impairment charges	–	–	**(39)**
Antitrust related charges (note 31)	(20)	(194)	**(20)**
Amortization of debt issuance costs	(4)	(8)	**(4)**
Other	17	18	**(11)**
Other operating expense, net	(85)	(257)	**(92)**

The average number of employees by geographic region is as follows for the years ended September 30:

	2003	2004	2005
Germany	16,043	16,340	**16,334**
Other Europe	4,753	5,507	**5,606**
North America	2,779	2,822	**3,108**
Asia-Pacific	7,725	9,220	**10,919**
Japan	108	126	**147**
Other	115	112	**44**
Total	31,523	34,127	**36,158**

(euro in millions, except where otherwise stated)

8 RESTRUCTURING

In 2003, the Company announced restructuring measures aimed at reducing costs, including downsizing its workforce, outsourcing and decentralizing certain functions and operations. As part of the restructuring, the Company planned to terminate approximately 550 employees, mainly in corporate functions and logic manufacturing operations, as well as through the outsourcing of certain functions to external providers.

In 2004, the Company announced further restructuring measures aimed at reducing costs, including downsizing its workforce and outsourcing and decentralizing certain functions and operations. As part of the restructuring, the Company announced plans to terminate approximately 325 employees. The 2004 terminations were primarily the result of relocating operations from Regensburg and Munich to Dresden and the downsizing of design centers in England, Ireland, Sweden, and the United States. These plans were completed in the 2005 financial year.

During the 2005 financial year, the Company agreed upon additional restructuring measures aimed at reducing costs, downsizing its workforce, and consolidating certain functions and operations. As part of the restructuring, the Company agreed upon plans to terminate approximately 350 employees. The terminations were primarily the result of the closedown of fiber optics operations in Germany and the United States. It is expected that the terminations will be completed in the 2006 financial year. In addition, the Company took measures to restructure its chip manufacturing within the manufacturing cluster Perlach, Regensburg, and Villach. Production from Munich-Perlach will be transferred primarily to Regensburg and to a lesser extent to Villach. Manufacturing at Munich-Perlach is expected to be phased out by early 2007 as numerous products complete their production life span. As part of the restructuring, the Company agreed upon plans to terminate approximately 600 employees. It is expected that the terminations will be completed in the 2007 financial year.

During the years ended September 30, 2003, 2004, and 2005, charges of €29, €17, and €78, respectively, were recognized as a result of the restructuring initiatives undertaken by the Company. In addition, during the 2003 financial year, €11 which had been previously accrued under restructuring, was forgiven in partial consideration for the execution of a service agreement and was therefore deferred, included in accrued liabilities, and recognized over the term of the service agreement.

The development of the restructuring liability during the year ended September 30, 2005, is as follows:

September 30	2004	2005			
	Liabilities	Reclassification	Restructuring charges	Payments	Liabilities
Employee terminations	10	**2**	**74**	**(22)**	**64**
Other exit costs	6	**–**	**4**	**(2)**	**8**
Total	16	**2**	**78**	**(24)**	**72**

(euro in millions, except where otherwise stated)

9 INCOME TAXES

Income (loss) before income taxes and minority interest is attributable to the following geographic locations for the years ended September 30, 2003, 2004, and 2005:

	2003	2004	2005
Germany	(506)	153	**(298)**
Foreign	147	44	**104**
Total	(359)	197	**(194)**

Income tax expense (benefits) for the years ended September 30, 2003, 2004, and 2005 is as follows:

	2003	2004	2005
Current taxes:			
Germany	18	53	**31**
Foreign	50	5	**1**
	68	58	**32**
Deferred taxes:			
Germany	40	129	**66**
Foreign	(24)	(33)	**22**
	16	96	**88**
Income tax expense	84	154	**120**

Total income taxes for the years ended September 30, 2003, 2004, and 2005 were allocated as follows:

	2003	2004	2005
Income taxes from continuing operations	84	154	**120**
Goodwill and intangible assets, for initial recognition of acquired tax benefits that previously were included in the valuation allowance (note 3)	(16)	(8)	**(30)**
Shareholders' equity, for unrealized holding gains (losses), unrealized gains (losses) on cash flow hedges and additional minimum pension liabilities	(4)	(10)	**–**
	64	136	**90**

The Company's statutory tax rate in Germany is 25%. Additionally, a solidarity surcharge of 5.5% and trade tax of 13% is levied, for a combined statutory tax rate of 39%.

A reconciliation of income taxes for the years ended September 30, 2003, 2004, and 2005, determined using the German corporate tax rate plus trade taxes, net of federal benefit, for a combined statutory rate of 41% (which includes a one year flood victim relief levy of 2%) for 2003 and 39% for 2004 and 2005 is as follows:

	2003	2004	2005
Expected (benefit) expense for income taxes	(147)	77	**(76)**
Increase in available tax credits	(35)	(26)	**(5)**
Non-taxable investment (income) loss	14	6	**(26)**
Foreign tax rate differential	1	(51)	**(18)**
Non-deductible expenses and other provisions	58	69	**29**
Change in German tax rate – effect on opening balance	2	–	**–**
Change in German tax rate – effect on current year	7	–	**–**
Increase in valuation allowance	182	54	**192**
In-process research and development	1	3	**–**
Other	1	22	**24**
Actual provision for income taxes	84	154	**120**

(euro in millions, except where otherwise stated)

Deferred income tax assets and liabilities as of September 30, 2004 and 2005, relate to the following:

	2004	2005
Deferred tax assets:		
Intangible assets	100	**26**
Property, plant and equipment	155	**203**
Deferred income	109	**111**
Net operating loss and tax credit carry-forwards	919	**1,065**
Other items	227	**169**
Gross deferred tax assets	1,510	**1,574**
Valuation allowance	(567)	**(740)**
Deferred tax assets	943	**834**
Deferred tax liabilities:		
Intangible assets	49	**11**
Property, plant and equipment	125	**81**
Accounts receivable	11	**36**
Accrued liabilities and pensions	75	**72**
Other items	39	**41**
Deferred tax liabilities	299	**241**
Deferred tax assets, net	644	**593**

Net deferred income tax assets and liabilities are presented in the accompanying consolidated balance sheets as of September 30, 2004 and 2005, as follows:

	2004	2005
Deferred tax assets:		
Current	140	**125**
Non-current	541	**550**
Deferred tax liabilities:		
Current	(16)	**(17)**
Non-current	(21)	**(65)**
Deferred tax assets, net	644	**593**

At September 30, 2005, the Company had in Germany tax loss carry-forwards of €2,140 (relating to both trade and corporate tax, plus an additional loss carry-forward applicable only to trade tax of €1,147); in other jurisdictions the Company had tax loss carry-forwards of €232 and tax effected credit carry-forwards of €107. Such tax loss carry-forwards and tax effected credit carry-forwards are generally limited to use by the particular entity that generated the loss or credit and do not expire under current law. The benefit for tax credits is accounted for on the flow-through method when the individual legal entity is entitled to the claim.

Pursuant to SFAS No. 109, the Company has assessed its deferred tax asset and the need for a valuation allowance. Such an assessment considers whether it is more likely than not that some portion or all of the deferred tax assets may not be realized. The assessment requires considerable judgment on the part of management, with respect to, among other factors, benefits that could be realized from available tax strategies and future taxable income, as well as other positive and negative factors. The ultimate realization of deferred tax assets is dependent upon the Company's ability to generate the appropriate character of future taxable income sufficient to utilize loss carry-forwards or tax credits before their expiration. Since the Company had incurred a cumulative loss in certain tax jurisdictions over a three-year period as of September 30, 2005, the impact of forecasted future taxable income is excluded from such an assessment, pursuant to the provisions of SFAS No. 109. For these tax jurisdictions, the assessment was therefore only based on the benefits that could be realized from available tax strategies and the reversal of temporary differences in future periods. As a result of this assessment, the Company increased the deferred tax asset valuation allowance as of September 30, 2005, by €192, to reduce the deferred tax asset to an amount that is more likely than not expected to be realized in future. During the years ended September 30, 2003 and 2004, valuation allowances relating to continuing operations in the amount of €182 and €54, respectively, were established for tax loss carry-forwards which, on a more likely than not basis, would not be fully utilized.

On December 27, 2003, the German government enacted new tax legislation which limits the application of a German corporation's tax loss carry-forwards to 60% of the annual taxable income of the corporation in any given year. The new legislation did not limit the length of the carry-forward period, which is unlimited. For the Company, the new tax law was effective starting in the 2004 financial year. The new legislation resulted in additional current tax of €13 and €0 for the years ended September 30, 2004 and 2005, respectively.

The changes in valuation allowance for deferred tax assets during the years ended September 30, 2004 and 2005, were as follows:

	2003	2004	2005
Balance, beginning of the year	310	521	**567**
Applicable to continuing operations	182	54	**192**
Deferred tax assets acquired in business combinations	45	–	**–**
Purchase accounting adjustments	(16)	(8)	**(30)**
Adjustment in corresponding net operating loss carry-forward	–	–	**11**
Balance, end of the year	521	567	**740**

(euro in millions, except where otherwise stated)

The Company did not provide for income taxes or foreign withholding taxes on cumulative earnings of foreign subsidiaries as of September 30, 2005, because these earnings are intended to be indefinitely reinvested in those operations. It is not practicable to estimate the amount of unrecognized deferred tax liabilities for these undistributed foreign earnings.

The Company reorganized certain businesses in different tax jurisdictions which resulted in deferred intercompany transactions. Therefore, tax expense for the years ended September 30, 2004 and 2005, of €54 and €85, respectively, have been deferred of which €39 and €71, respectively, are non-current (see note 17).

10 EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share ("EPS") is calculated by dividing net income (loss) by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is calculated by dividing net income by the sum of the weighted average number of ordinary shares outstanding plus all additional ordinary shares that would have been outstanding if potentially dilutive instruments or ordinary share equivalents had been issued.

The computation of basic and diluted EPS for the years ended September 30, 2003, 2004, and 2005, is as follows (shares in million):

	2003	2004	2005
Numerator:			
Net income (loss)	(435)	61	**(312)**
Denominator:			
Weighted-average shares outstanding – basic	720.9	734.7	**747.6**
Effect of dilutive instruments	–	1.9	**–**
Weighted-average shares outstanding – diluted	720.9	736.6	**747.6**
Earnings (loss) per share in €**:**			
Basic and diluted	(0.60)	0.08	**(0.42)**

The weighted average of potentially dilutive instruments that were excluded from the diluted earnings (loss) per share computations, because the exercise price was greater than the average market price of the ordinary shares during the period or were otherwise not dilutive, include 28.0 million, 24.1 million, and 39.4 million shares underlying employee stock options for the years ended 2003, 2004, and 2005, respectively. Additionally, 96.6 million, 86.5 million, and 86.5 million ordinary shares issuable upon the conversion of the subordinated convertible notes at September 30, 2003, 2004, and 2005, respectively, were not included in the computation of diluted earnings (loss) per share as their impact would have been antidilutive.

11 MARKETABLE SECURITIES

Marketable securities at September 30, 2004 and 2005, consist of the following:

	2004				2005			
	Cost	Fair value	Unrealized gain	Unrealized loss	Cost	Fair value	Unrealized gain	Unrealized loss
Foreign government securities	9	10	1	–	**9**	**11**	**2**	**–**
Floating rate notes	548	551	7	(4)	**260**	**268**	**8**	**–**
Other debt securities	271	272	1	–	**16**	**18**	**2**	**–**
Total debt securities	828	833	9	(4)	**285**	**297**	**12**	**–**
Equity securities	13	12	1	(2)	**4**	**5**	**1**	**–**
Fixed term deposits	1,112	1,112	–	–	**590**	**590**	**2**	**(2)**
Total marketable securities	1,953	1,957	10	(6)	**879**	**892**	**15**	**(2)**
Reflected as follows								
Current assets	1,935	1,938	9	(6)	**850**	**858**	**10**	**(2)**
Non-current assets (note 17)	18	19	1	–	**29**	**34**	**5**	**–**
Total marketable securities	1,953	1,957	10	(6)	**879**	**892**	**15**	**(2)**

(euro in millions, except where otherwise stated)

Unrealized losses relating to securities held for more than 12 months as of September 30, 2004 and 2005, were €4 and €0, respectively.

Realized (losses) gains, net, are reflected as other non-operating income (expense), net, and were as follows for the years ended September 30:

	2003	2004	2005
Realized gains	60	10	**8**
Realized losses	(4)	(1)	**–**
Realized gains (losses), net	56	9	**8**

As of September 30, 2005, fixed term deposits of €5 had contractual maturities between three and twelve months.

Debt securities as of September 30, 2005, had the following remaining contractual maturities:

	Cost	Fair value
Less than 1 year	262	**270**
Between 1 and 5 years	4	**5**
More than 5 years	19	**22**
Total debt securities	285	**297**

Actual maturities may differ due to call or prepayment rights.

12 TRADE ACCOUNTS RECEIVABLE, NET

Trade accounts receivable at September 30, 2004 and 2005, consist of the following:

	2004	2005
Third party – trade	879	**839**
Siemens group – trade (note 27)	206	**145**
Associated and Related Companies – trade (note 27)	12	**12**
Trade accounts receivable, gross	1,097	**996**
Allowance for doubtful accounts	(41)	**(44)**
Trade accounts receivable, net	1,056	**952**

Activity in the allowance for doubtful accounts for the years ended September 30, 2004 and 2005, is as follows:

	2004	2005
Allowance for doubtful accounts at beginning of year	26	**41**
Provision for bad debt, net	15	**3**
Allowance for doubtful accounts at end of year	41	**44**

13 INVENTORIES

Inventories at September 30, 2004 and 2005, consist of the following:

	2004	2005
Raw materials and supplies	84	**87**
Work-in-process	560	**569**
Finished goods	316	**366**
Total inventories	960	**1,022**

14 OTHER CURRENT ASSETS

Other current assets at September 30, 2004 and 2005, consist of the following:

	2004	2005
Financial instruments (note 29)	106	**73**
Assets held for sale	88	**–**
Grants receivable	84	**122**
VAT and other tax receivables	147	**84**
License fees receivable	–	**19**
Associated and Related Companies – financial and other receivables (note 27)	49	**5**
Third party – financial and other receivables	40	**68**
Siemens group – financial and other receivables (note 27)	18	**18**
Prepaid expenses	19	**26**
Employee receivables (note 27)	9	**8**
Intangible pension asset (note 28)	–	**14**
Other	30	**32**
Total other current assets	590	**469**

(euro in millions, except where otherwise stated)

At September 30, 2004, other current assets included assets held for sale relating to the Company's fiber optics business (see note 4).

Summarized balance sheet information for the fiber optics business is set forth below:

September 30	2004
Current assets	47
Non-current assets	41
Total assets held for sale	88
Current liabilities	23
Non-current liabilities	8
Total liabilities related to assets held for sale (note 20)	31

There are no assets held for sale for the fiber optics business as of September 30, 2005.

On April 23, 2004, the Company announced plans to recommence the expansion of capacity at its Richmond, Virginia, plant, which involved the completion of construction and equipment installation for a 300-millimeter fabrication facility. The construction and qualification of the expanded facility was completed during the 2005 financial year and commercial production began during the fourth quarter of the 2005 financial year. The total investment in the expansion of the Richmond plant amounted to €787.

On December 8, 2004, the Company announced plans to build a new front-end production plant in Kulim High Tech Park, Malaysia. The facility will mainly produce power and logic chips used in automotive and industrial power applications. The Company plans to invest in total approximately $1 billion. The construction started in early 2005 and the start of production is scheduled for 2006. As of September 30, 2005, the Company had invested a total of €39 in this new front-end production plant.

15 PROPERTY, PLANT AND EQUIPMENT, NET

A summary of activity for property, plant and equipment for the year ended September 30, 2005, is as follows:

	Land and buildings	Technical equipment and machinery	Other plant and office equipment	Construction in progress	Total
Cost					
September 30, 2004	1,101	7,002	2,176	484	**10,763**
Additions	30	385	151	832	**1,398**
Impairments	(15)	(19)	(5)	–	**(39)**
Disposals	(3)	(558)	(212)	–	**(773)**
Reclassifications	–	(2)	34	–	**32**
Transfers	292	685	80	(1,057)	**–**
Foreign currency effects	22	56	8	(6)	**80**
September 30, 2005	1,427	7,549	2,232	253	**11,461**
Accumulated depreciation					
September 30, 2004	(548)	(4,752)	(1,876)	–	**(7,176)**
Depreciation	(73)	(910)	(237)	–	**(1,220)**
Disposals	3	513	205	–	**721**
Transfers	–	–	–	–	**–**
Foreign currency effects	(4)	(26)	(5)	–	**(35)**
September 30, 2005	(622)	(5,175)	(1,913)	–	**(7,710)**
Book value September 30, 2004	553	2,250	300	484	**3,587**
Book value September 30, 2005	805	2,374	319	253	**3,751**

(euro in millions, except where otherwise stated)

16 LONG-TERM INVESTMENTS, NET

A summary of activity for long-term investments for the year ended September 30, 2005, is as follows:

	Investment in associated companies	Investment in related companies	Total
Balance at September 30, 2004	664	44	**708**
Additions	87	48	**135**
Disposals	–	(71)	**(71)**
Dividend payments	(51)	–	**(51)**
Capitalized interest	(1)	–	**(1)**
Impairments	(26)	(3)	**(29)**
Equity in earnings	57	–	**57**
Reclassification	(16)	3	**(13)**
Foreign currency effects	44	–	**44**
Balance at September 30, 2005	758	21	**779**

Investments in Related Companies principally relate to investment activities aimed at strengthening the Company's future intellectual property potential.

The following significant Associated Companies as of September 30, 2005, are accounted for using the equity method of accounting:

Name of the associated company	Direct and indirect ownership
Advanced Mask Technology Center GmbH & Co. KG, Dresden, Germany ("AMTC")	**33.3 %**
ALTIS Semiconductor S.N.C., Essonnes, France ("ALTIS")	**50.1 %**
Hwa-Ken Investment Inc., Taipei, Taiwan ("Hwa-Ken")	**50.0 %**
Inotera Memories Inc., Taoyuan, Taiwan ("Inotera")	**45.9 %**
StarCore LLC, Austin, Texas, USA ("StarCore")	**41.1 %**

The Company has accounted for these investments under the equity method of accounting due to the lack of unilateral control (see note 2). The above companies are principally engaged in the research and development, design, and manufacture of semiconductors and related products.

On May 16, 2002, the Company entered into the AMTC joint venture with its Partners Advanced Micro Devices Inc., USA ("AMD"), and DuPont Photomasks Inc., USA ("DuPont"), with the purpose of developing and manufacturing advanced photo masks. In addition, the Company agreed to sell specified photomask equipment to DuPont, and entered into a long-term purchase agreement through 2011. Accordingly, as of September 30, 2005, €17 was deferred which is being recognized over the term of the purchase agreement. Toppan Printing Co., Ltd. acquired DuPont in April 2005 which led to a name change; the former DuPont is now named Toppan Photomasks Inc., Ltd.

ALTIS is a joint venture between the Company and International Business Machines Corporation ("IBM"), with each having equal voting representation. During the year ended September 30, 2003, the Company and IBM amended the original shareholders agreement. Pursuant to the amendment, the Company will ratably increase its capacity reservation in the production output of ALTIS from 50% to 100% during calendar years 2004 through 2007. IBM and the Company agreed that they will decide the future business model of ALTIS not later than January 1, 2007. Additionally, the Company was granted an option through July 1, 2007, to acquire IBM's interest in ALTIS. The Company is currently in negotiations with IBM regarding the future business model of ALTIS.

On November 13, 2002, the Company entered into agreements with Nanya relating to a strategic cooperation in the development of DRAM products and the foundation of a joint venture (Inotera, held directly and indirectly through the Company's investment in Hwa-Ken Investment Inc.) to construct and operate a 300-millimeter manufacturing facility in Taiwan. Pursuant to the agreements, the Company and Nanya had developed advanced 90-nanometer technology, and are developing 70-nanometer technology, the cost of which will be borne two-thirds by the Company and one-third by Nanya. The new 300-millimeter manufacturing facility is funded by Inotera and employs the technology developed under the aforementioned agreements to manufacture DRAM products, and its capacity is anticipated to be completed in three phases. During the year ended September 30, 2004, Inotera completed the construction and started mass production. The second phase was completed in the 2005 financial year, while the third phase is anticipated to be completed in the 2006 financial year. The joint venture partners are obliged to each purchase one-half of the facility's production based, in part, on market prices. On September 29, 2005, the Company and Nanya signed an agreement to expand their development cooperation in respect of DRAM products. The agreement provides for the joint development of advanced 60-nanometer production technologies for 300-millimeter wafers, starting September 2005. The cost of the development will be borne two-thirds by the Company and one-third by Nanya.

(euro in millions, except where otherwise stated)

The cooperation is the extension of the existing co-development of 90 and 70-nanometer production technologies, and is expected to help each partner expand its position in the DRAM market while sharing development costs. The first 300-millimeter wafer memory products using the new 60-nanometer process are expected to leave the production line in 2008.

The Company invested €342 and €83 in Inotera during the years ended September 30, 2004 and 2005, respectively. The investment includes interest capitalization of €7 and €6 during the years ended September 30, 2004 and 2005, respectively. During the year ended September 30, 2004, Inotera issued shares to employees which diluted the Company's shareholding at that time while increasing its proportional share of Inotera shareholders' equity by €2. At September 30, 2005, the Company's direct and indirect ownership interest in Inotera was 45.9%.

On October 7, 2004, Inotera's application for public company status was accepted by the Taiwanese Securities and Futures Bureau. Since April 2005, Inotera has been listed on the GreTai market in Taiwan. On October 26, 2005, Inotera submitted an application for an initial public offering of its common stock to the Taiwanese stock exchange.

In November 2003 the Company, together with United Epitaxy Company, Ltd. ("UEC"), Hsinchu, Taiwan, founded a joint venture company ParoLink. The Company initially invested €6, held a 56% ownership interest in ParoLink and accounted for its investment in ParoLink using the equity method, since substantive participating minority rights prevented the exercise of unilateral control. In connection with the Company's disposal of its fiber optics business (see note 4), the Company acquired the minority interest in ParoLink, terminated the joint venture with UEC and recorded an impairment to reduce the investment to its estimated fair value of €3.

On October 1, 2002, the Company, Agere Systems Inc., and Motorola Inc. incorporated StarCore, based in Austin, Texas. StarCore focuses on developing, standardizing, and promoting Digital Signal Processor (DSP) core technology. As of September 30, 2005, the Company held a 41.1% ownership interest with an aggregate value of €15.

The Company recognized impairment charges related to certain investments for which the carrying value exceeded the fair value on an other-than-temporary basis, of €30, €65, and €29 for the years ended September 30, 2003, 2004, and 2005, respectively. In connection with the termination of the Company's venture capital activities, an impairment charge of €28 was recognized as of September 30, 2004, to reduce the carrying value of the Company's venture investment portfolio to the expected realizable value (see note 4).

Goodwill of €32 and €15 is included in the amount of long-term investments at September 30, 2004 and 2005, respectively.

For the Associated Companies as of September 30, 2005, the aggregate summarized financial information for the financial years 2003, 2004, and 2005, is as follows:

	2003	2004	2005
Sales	596	539	**969**
Gross profit	65	26	**187**
Net income (loss)	2	(25)	**90**

	2003	2004	2005
Current assets	243	400	**744**
Non-current assets	679	1,492	**2,234**
Current liabilities	(302)	(383)	**(452)**
Non-current liabilities	(15)	(338)	**(908)**
Shareholders' equity	605	1,171	**1,618**

17 OTHER ASSETS

Other non-current assets at September 30, 2004 and 2005, consist of the following:

	2004	2005
Intangible assets, net	398	**315**
Grants receivable	92	**–**
Deferred tax expense (note 9)	39	**71**
Prepaid pension cost (note 28)	27	**–**
Long-term receivables	24	**23**
Marketable securities (note 11)	19	**34**
Associated and Related Companies – financial and other (note 27)	10	**67**
Notes receivable	3	**–**
Employee receivables (note 27)	2	**2**
Other	13	**30**
Total	627	**542**

(euro in millions, except where otherwise stated)

A summary of activity for intangible assets for the years ended September 30, 2004 and 2005, is as follows:

	Goodwill	Other intangibles	Total
Cost			
September 30, 2003	243	339	**582**
Additions	–	125	**125**
Impairment charges (note 7)	(71)	–	**(71)**
Disposals	–	(75)	**(75)**
Acquisitions (note 3)	23	30	**53**
Purchase accounting adjustments (note 3)	(8)	–	**(8)**
Foreign currency effects	(15)	(5)	**(20)**
September 30, 2004	172	414	**586**
Additions	–	64	**64**
Impairment charges (note 7)	(18)	(39)	**(57)**
Disposals	(6)	(36)	**(42)**
Acquisitions (note)	7	58	**65**
Purchase accounting adjustments (note 3)	(14)	(16)	**(30)**
Foreign currency effects	2	3	**5**
September 30, 2005	143	448	**591**
Accumulated amortization			
September 30, 2003	(25)	(146)	**(171)**
Amortization	–	(89)	**(89)**
In-process R&D	–	(9)	**(9)**
Disposals	–	75	**75**
Foreign currency effects	4	2	**6**
September 30, 2004	(21)	(167)	**(188)**
Amortization	–	(96)	**(96)**
Disposals	–	5	**5**
Foreign currency effects	3	–	**3**
September 30, 2005	(18)	(258)	**(276)**
Carrying value September 30, 2003	218	193	**411**
Carrying value September 30, 2004	151	247	**398**
Carrying value September 30, 2005	125	190	**315**

The estimated aggregate amortization expense relating to other intangible assets for each of the five succeeding financial years is as follows: 2006 €59; 2007 €51; 2008 €29; 2009 €11; 2010 €7.

In June 2003, the Company entered into technology development and license agreements with IBM and Chartered Semiconductor for advanced logic process manufacturing technology. Licenses of €43 are amortized over the expected life of the related technology of five years.

In connection with the acquisition of Saifun's remaining 30% share in the Infineon Technologies Flash joint venture, the Company was granted a license for the use of Saifun NROM® technologies (see note 3). The license of €28 is being amortized over the expected useful life of the related technologies of ten years.

In March 2005, the Company and Rambus reached an agreement settling all claims between them and licensing the Rambus patent portfolio. The license of €37 is being amortized over the expected useful life of the related technologies of ten years.

During the years ended September 30, 2003, 2004, and 2005, the Company recognized intangible assets impairment charges of €68, €71, and €57, respectively.

As a result of the combination of below-forecasted operating results and moderated market expectations, the Company, taking the technical milestones achieved to date into account, revised the forecasted returns for the optical networking reporting unit of the Communication segment. Accordingly, the Company tested the reporting unit's goodwill for impairment using a present value technique based on discounted estimated future cash flows pursuant to SFAS No. 142 and recognized an impairment charge of €68 during the year ended September 30, 2003.

As part of the Company's annual goodwill impairment test for the year ended September 30, 2004, the Company recognized an impairment charge of €71 to reduce the reporting unit's goodwill to its estimated fair value, principally as a result of a decline in revenue and lowered market development expectations during the 2004 financial year.

During the year ended September 30, 2005, the Company concluded that sufficient indicators existed to require an assessment of whether the carrying values of goodwill and certain other intangible assets in the Customer Premises Equipment, Wireless Infrastructure, Short Range Wireless, RF Engine and Optical Networking reporting units within the Communication segment may not be recoverable. Recoverability of these intan-

(euro in millions, except where otherwise stated)

gible assets was measured by a comparison of the carrying amount of the assets to the future net cash flows expected to be generated by the assets. Impairments of €57 were recognized in other operating expenses, representing the amount by which the carrying amount of the assets exceeded their fair value.

18 TRADE ACCOUNTS PAYABLE

Trade accounts payable at September 30, 2004 and 2005, consist of the following:

	2004	2005
Third party – trade	969	**868**
Siemens group – trade (note 27)	61	**61**
Associated and Related Companies – trade (note 27)	68	**140**
Total	1,098	**1,069**

19 ACCRUED LIABILITIES

Accrued liabilities at September 30, 2004 and 2005, consist of the following:

	2004	2005
Personnel costs	279	**274**
Warranties and licenses	78	**53**
Settlement for antitrust related matters (note 31)	67	**31**
Interest	33	**34**
Other	98	**105**
Total	555	**497**

On September 15, 2004, the Company entered into a plea agreement with the United States Department of Justice in connection with its antitrust investigation (see note 31) and agreed to pay a fine aggregating $160 million over a five-year period. The related amount due within one year is included in accrued and other current liabilities, and the long-term portion is reflected as other non-current liabilities (see note 22).

20 OTHER CURRENT LIABILITIES

Other current liabilities at September 30, 2004 and 2005, consist of the following:

	2004	2005
VAT and other taxes payable	272	**202**
Payroll obligations to employees	124	**130**
Deferred government grants (note 6)	90	**106**
Other deferred income	58	**22**
Restructuring (note 8)	16	**72**
Financial instruments (note 29)	17	**74**
Associated and Related Companies – financial and other (note 27)	2	**4**
Liabilities related to assets held for sale (note 14)	31	**–**
Settlement for antitrust related matters (note 31)	–	**31**
Other	20	**59**
Total	630	**700**

Other deferred income includes amounts relating to license income (see note 5) and deferred revenue. The non-current portion is included in other liabilities (see note 22).

(euro in millions, except where otherwise stated)

21 DEBT

Debt at September 30, 2004 and 2005, consists of the following:

	2004	2005
Short-term debt:		
Loans payable to banks, weighted average rate 2.21 %	53	**51**
Loans payable, weighted average rate 4.5 %	18	**–**
Current portion of long-term debt	498	**48**
Capital lease obligations	2	**–**
Total short-term debt and current maturities	571	**99**
Long-term debt:		
Convertible subordinated notes, 4.25 %, due 2007	636	**633**
Convertible subordinated notes, 5.0 %, due 2010	688	**690**
Loans payable to banks:		
Unsecured term loans, weighted average rate 2.58 %, due 2006–2013	69	**206**
Secured term loans, weighted average rate 1.50 %, due 2006–2010	7	**9**
Notes payable to governmental entity, rate 3.18 %, due 2027	27	**28**
Total long-term debt	1,427	**1,566**

Short-term loans payable to banks consist primarily of borrowings under the terms of short-term borrowing arrangements. The loans payable, representing working capital advances to the Company's flash memory subsidiaries in the amount of €18 as of September 30, 2004, were netted against the purchase price as part of the acquisition of the minority interest in the Company's Flash joint venture (see note 3).

On June 5, 2003, the Company (as guarantor), through its subsidiary Infineon Technologies Holding B.V. (as issuer), issued €700 in subordinated convertible notes due 2010 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 68.4 million ordinary shares of the Company, at a conversion price of euro 10.23 per share through maturity. Upon conversion, the Company may pay a cash amount in lieu of delivery of all or part of the shares. The notes accrue interest at 5.0% per year. The notes are unsecured and pari passu with all present and future unsecured subordinated obligations of the issuer, and cannot be converted for the first three years. The note holders have a negative pledge relating to future capital market indebtedness, as defined. The note holders have an early redemption option in the event of a change of control, as defined. A corporate reorganization resulting in a substitution of the guarantor shall not be regarded as a change of control, as defined. The Company may redeem the convertible notes after three years at their principal amount plus interest accrued thereon, if the Company's share price exceeds 125% of the conversion price on 15 trading days during a period of 30 consecutive trading days. The convertible notes are listed on the Luxembourg Stock Exchange. At September 30, 2005, unamortized debt issuance costs were €10.

On February 6, 2002, the Company (as guarantor), through its subsidiary Infineon Technologies Holding B.V. (as issuer), issued €1,000 in subordinated convertible notes due 2007 at par in an underwritten offering to institutional investors in Europe. The notes are convertible, at the option of the holders of the notes, into a maximum of 28.2 million of the Company's ordinary shares at a conversion price of euro 35.43 per share through maturity. Upon conversion, the Company may pay a cash amount in lieu of delivery of all or part of the shares. The convertible notes accrue interest at 4.25% per year. The notes are unsecured and pari passu with all present and future unsecured subordinated obligations of the issuer. The note holders have a negative pledge relating to any future capital market indebtedness, as defined. The note holders have an early redemption option in the event of a change of control, as defined. The Company may redeem the convertible notes after three years at their principal amount plus interest accrued thereon, if the Company's share price exceeds 115% of the conversion price on 15 trading days during a period of 30 consecutive trading days. The convertible notes are listed on the Luxembourg Stock Exchange. During the financial year ended September 30, 2004, the Company redeemed a notional amount of €360 of the convertible subordinated notes due 2007, which resulted in a net gain of €6 before tax. At September 30, 2005, the outstanding notional amount was €640 and unamortized debt issuance costs were €3.

(euro in millions, except where otherwise stated)

A €450 syndicated credit facility relating to the expansion of the Dresden manufacturing facility, which was fully drawn as of September 30, 2004, and had been reported under current portion of long-term debt, was repaid as of September 30, 2005.

In September 2004 the Company executed a $400/€400 syndicated credit facility with a five year term. The facility consists of two tranches: Tranche A is a $400 million term loan intended to finance the expansion of its Richmond, Virginia, manufacturing facility. Tranche B is a €400 multicurrency revolving facility to be used for general corporate purposes. The maximum outstanding amount of Tranche A will decrease on the basis of a repayment schedule that foresees equal installments starting from September 30, 2006. The facility has customary financial covenants, and drawings bear interest at market-related rates that are linked to financial performance. The lenders have been granted a negative pledge relating to the Company's future financial indebtedness with certain permitted encumbrances. At September 30, 2005, no amounts were outstanding under this facility.

A €124 non-recourse project financing facility for the expansion of the Porto, Portugal, manufacturing facility was executed in May 2005. At September 30, 2005, an amount of €80 has been drawn under this facility. The Company anticipates satisfying the repayment schedule starting 2008 and ending 2013 from available funds.

The Company has established independent financing arrangements with several financial institutions, in the form of both short and long-term credit facilities, which are available for anticipated funding purposes:

			As of September 30, 2005		
Term	Nature of financial institution commitment	Purpose/intended use	Aggregate facility	Drawn	Available
short-term	firm commitment	working capital, guarantees	120	51	69
short-term	no firm commitment	working capital, cash management	305	–	305
long-term	firm commitment	working capital	731	–	731
long-term[1]	firm commitment	project finance	335	291	44
Total			1,491	342	1,149

1 Including current maturities.

At September 30, 2005, the Company was in compliance with its debt covenants under the relevant facilities. Interest expense for the years ended September 30, 2003, 2004, and 2005 was €115, €126, and €83, respectively.

Aggregate amounts of debt maturing subsequent to September 30, 2005, are as follows:

Year ending September 30	Amount
2006	99
2007	650
2008	51
2009	64
2010	733
Thereafter	68
Total	1,665

22 OTHER LIABILITIES

Other non-current liabilities at September 30, 2004 and 2005, consist of the following:

	2004	2005
Deferred government grants (note 6)	191	**182**
Settlement for antitrust related matters (note 31)	109	**88**
Pension liabilities (note 28)	98	**162**
Long-term advance	45	**–**
Minority interest	39	**81**
Deferred income (note 5)	18	**38**
Post-retirement benefits (note 28)	5	**5**
Other	63	**86**
Total	568	**642**

(euro in millions, except where otherwise stated)

23 ORDINARY SHARE CAPITAL

As of September 30, 2005, the Company had 747,569,359 registered ordinary shares of euro 2.00 notional value per share outstanding. During the year ended September 30, 2004, the Company increased its share capital by €53 by issuing 26,679,255 shares valued at €278 in connection with the acquisition of the remaining interests of other investors in the SC300 GmbH & Co. KG ("SC300"). During the year ended September 30, 2003, due to the achievement of certain milestones, 96,386 shares representing contingent purchase consideration in connection with the Catamaran acquisition, were released from third party escrow, and are reflected as issued in the accompanying statement of shareholders' equity.

Authorized and conditional share capital

In addition to the issued share capital, the Company's Articles of Association authorize the Management Board to increase the ordinary share capital with the Supervisory Board's consent by issuing new shares. As of September 30, 2005, the Management Board may use these authorizations to issue new shares as follows:

- Through January 21, 2007, Authorized Share Capital I/2002 – in an aggregate nominal amount of up to €297 to issue shares for cash, where the preemptive rights of shareholders may be partially excluded, or in connection with business combinations (contributions in kind), where the preemptive rights of shareholders may be excluded for all shares.
- Through January 19, 2009, Authorized Share Capital II/2004 – in an aggregate nominal amount of up to €30 to issue shares to employees (in which case the preemptive rights of existing shareholders are excluded).

The Company has conditional capital of up to an aggregate nominal amount of €96 (Conditional Share Capital I) and of up to an aggregate nominal amount of €29 (Conditional Share Capital III) that may be used to issue up to 62.5 million new registered shares in connection with the Company's long-term incentive plans (see note 24). These shares will have dividend rights from the beginning of the financial year in which they are issued.

The Company has conditional capital of up to an aggregate nominal amount of €50 (Conditional Share Capital II) that may be used to issue up to 25 million new registered shares upon conversion of debt securities, issued in February 2002, and which may be converted at any time until January 23, 2007 (see note 21). These shares will have dividend rights from the beginning of the financial year in which they are issued.

The Company has conditional capital of up to an aggregate nominal amount of €136.8 (Conditional Share Capital II/2002) that may be used to issue up to 68.4 million new registered shares upon conversion of debt securities, issued in June 2003, and which may be converted at any time until May 22, 2010 (see note 21). These shares will have dividend rights from the beginning of the financial year in which they are issued.

The Company has further conditional capital of up to an aggregate nominal amount of €213.2 (Conditional Share Capital II/2002) that may be used to issue up to 106.6 million new registered shares upon conversion of debt securities which may be issued before January 21, 2007. These shares will have dividend rights from the beginning of the financial year in which they are issued.

Dividends

Under the German Stock Corporation Act (Aktiengesetz), the amount of dividends available for distribution to shareholders is based on the level of earnings (Bilanzgewinn) of the ultimate parent, as determined in accordance with the HGB. All dividends must be approved by shareholders.

The ordinary shareholders meeting held in January 2005 did not authorize a dividend. No earnings are available for distribution as a dividend for the 2005 financial year, since Infineon Technologies AG on a stand-alone basis as the ultimate parent incurred a cumulative loss (Bilanzverlust) as of September 30, 2005.

24 STOCK-BASED COMPENSATION

Fixed stock option plans

In 1999, the shareholders approved a share option plan (the "LTI 1999 Plan"), which provided for the granting of non-transferable options to acquire ordinary shares over a future period. Under the terms of the LTI 1999 Plan, the Company could grant up to 48 million options over a five-year period. The exercise price of each option equals 120% of the average closing price of the Company's stock during the five trading days prior to the grant date. Granted options vest at the latter of two years from the grant date or the date on which the Company's stock reaches the exercise price for at least one trading day. Options expire seven years from the grant date.

In 2001, the Company's shareholders approved the International Long-Term Incentive ("LTI") Plan (the "LTI 2001 Plan") which replaced the LTI 1999 Plan. Options previously issued under the LTI 1999 Plan remain unaffected as to terms and conditions; however, no additional options may be issued under the LTI 1999 Plan. Under the terms of the LTI 2001 Plan, the Company can grant up to 51.5 million options over a five-year period. The exercise price of each option equals 105% of the average closing price of the Company's stock during the five trading days prior to the grant date. Granted options have a vesting period of between two and four years, subject to the Company's stock reaching the exercise price on at least one trading day, and expire seven years from the grant date.

Under the LTI 2001 Plan, the Company's Supervisory Board will decide annually within three months after publication of the financial results how many options to grant to the Management Board. The Management Board will, within the same three-month period, decide how many options to grant to eligible employees.

A summary of the status of the LTI 1999 Plan and the LTI 2001 Plan as of September 30, 2005, and changes during the three years then ended is presented below (options in millions, exercise price in euro):

	2003		2004		2005	
	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price
Outstanding at beginning of year	19.9	€35.96	29.9	€25.56	**36.0**	**€22.59**
Granted	11.7	€8.97	8.1	€12.32	**6.7**	**€9.10**
Exercised	–	–	–	–	**–**	**–**
Forfeited and expired	(1.7)	€32.80	(2.0)	€25.17	**(1.8)**	**€24.07**
Outstanding at end of year	29.9	€25.56	36.0	€22.59	**40.9**	**€20.33**
Exercisable at end of year	9.6	€48.56	13.2	€39.89	**19.6**	**€29.93**

The following table summarizes information about stock options outstanding and exercisable at September 30, 2005 (options in millions, exercise price in euro):

	Outstanding			Exercisable	
Range of exercise prices	Number of options	Weighted-average remaining life (in years)	Weighted-average exercise price	Number of options	Weighted-average exercise price
€5 – €10	16.6	4.95	€8.99	5.0	€8.93
€10 – €15	8.9	4.98	€12.41	1.0	€12.63
€15 – €20	0.2	3.84	€15.75	0.1	€15.75
€20 – €25	6.7	3.18	€23.70	5.0	€23.70
€25 – €30	0.1	3.02	€27.40	0.1	€27.43
€40 – €45	4.2	1.46	€42.03	4.2	€42.03
€50 – €55	0.1	2.50	€53.26	0.1	€53.26
€55 – €60	4.1	2.16	€55.18	4.1	€55.18
Total	40.9	4.02	€20.33	19.6	€29.93

Fair value disclosures

As described in note 2, the Company applies APB Opinion 25 and its related interpretations to account for stock-based compensation. SFAS No. 123 establishes an alternative to determine compensation expense based on the fair value of the options at the grant date calculated through the use of option pricing models. Option pricing models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from the options granted to the Company's employees with their exercise restrictions. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The Company estimated the fair value of each option grant at the date of grant using a Black-Scholes option-pricing model based on a single-option valuation approach with forfeitures recognized as they occur. The following weighted-average assumptions were used for grants for the years ended September 30:

	2003	2004	2005
Weighted-average assumptions:			
Risk-free interest rate in %	3.85	3.68	**3.02**
Expected volatility in %	59	59	**58**
Dividend yield in %	0	0	**0**
Expected life in years	4.50	4.50	**4.50**
Weighted-average fair value per option at grant date in €	4.41	5.88	**4.03**

If the Company had accounted for stock option grants and employee stock purchases under its plans according to the fair value method of SFAS No. 123, and thereby recognized compensation expense based on the above fair values over the respective option vesting periods, net income (loss) and earnings (loss) per share would have been reduced (increased) to the pro forma amounts indicated below, pursuant to the provisions of SFAS No. 148 for the years ended September 30:

	2003	2004	2005
Net (loss) income:			
As reported	(435)	61	**(312)**
Deduct:			
Stock-based employee compensation expense included in reported net (loss) income, net of related tax effects	7	2	**–**
Add:			
Total stock-based employee compensation expense determined under fair–value-based method for all awards, net of related tax effects	(43)	(37)	**(39)**
Pro forma	(471)	26	**(351)**
Basic earnings (loss) per share:			
As reported	€(0.60)	€0.08	**€(0.42)**
Pro forma	€(0.65)	€0.03	**€(0.47)**

(euro in millions, except where otherwise stated)

25 OTHER COMPREHENSIVE INCOME (LOSS)

The changes in the components of other comprehensive income (loss) for the years ended September 30, 2003, 2004, and 2005 are as follows:

	2003			2004			2005		
	Pretax	Tax effect	Net	Pretax	Tax effect	Net	Pretax	Tax effect	Net
Unrealized (losses) gains on securities:									
Unrealized holding (losses) gains	11	–	11	4	–	4	**13**	**(1)**	**12**
Reclassification adjustment for losses (gains) included in net income (loss)	4	(2)	2	(11)	–	(11)	**(4)**	**–**	**(4)**
Net unrealized (losses) gains	15	(2)	13	(7)	–	(7)	**9**	**(1)**	**8**
Unrealized gains (losses) on cash flow hedges	–	–	–	1	–	1	**(25)**	**–**	**(25)**
Additional minimum pension liability	4	(2)	2	28	(10)	18	**(85)**	**1**	**(84)**
Foreign currency translation adjustment	(76)	–	(76)	(41)	–	(41)	**64**	**–**	**64**
Other comprehensive (loss) income	(57)	(4)	(61)	(19)	(10)	(29)	**(37)**	**–**	**(37)**
Accumulated other comprehensive income (loss) – beginning of year	(41)	14	(27)	(98)	10	(88)	**(117)**	**–**	**(117)**
Accumulated other comprehensive income (loss) – end of year	(98)	10	(88)	(117)	–	(117)	**(154)**	**–**	**(154)**

26 SUPPLEMENTAL CASH FLOW INFORMATION

The Company issued shares to redeem the redeemable interest of €278 related to the SC300 venture during the year ended September 30, 2004 (see note 23).

Following the Company's spin-off from Siemens, the Company established a pension plan for its U.S. employees separate from the Siemens U.S. pension plan. At the time of the spin-off, the funded status of the Company's allocated portion of the Siemens U.S. pension plan relating to the transferred employees was reflected as an accrued pension liability. Subsequently, Siemens transferred assets to fund this liability based on an actuarial determination. The difference between the actuarial valuation at the funding date and the originally allocated liability of €(6) is reflected as an equity transaction during the year ended September 30, 2003.

	2003	2004	2005
Cash paid for:			
Interest	104	144	**91**
Income taxes	53	59	**79**
Operating activities:			
Cash received for tax-free government grants	34	65	**33**
Non-cash investing and financing activities:			
Contributions to Siemens	(6)	–	**–**
Assets acquired through capital lease transactions	5	–	**–**

(euro in millions, except where otherwise stated)

27 RELATED PARTIES

The Company has transactions in the normal course of business with Siemens group companies and with Related and Associated Companies (together, "Related Parties"). The Company purchases certain of its raw materials, especially chipsets, from, and sells certain of its products to, Related Parties. Purchases and sales to Related Parties are generally based on market prices or manufacturing cost plus a mark-up.

Related Party receivables at September 30, 2004 and 2005, consist of the following:

	2004	2005
Current:		
Siemens group – trade	206	**145**
Associated and Related Companies – trade	12	**12**
Siemens group – financial and other (note 14)	18	**18**
Associated and Related Companies – financial and other (note 14)	49	**5**
Employee receivables (note 14)	9	**8**
	294	**188**
Non-current:		
Associated and Related Companies – financial and other (note 17)	10	**67**
Employee receivables (note 17)	2	**2**
	12	**69**
Total Related Party receivables	306	**257**

Related Party payables at September 30, 2004 and 2005, consist of the following:

	2004	2005
Siemens group – trade (note 18)	61	**61**
Associated and Related Companies – trade (note 18)	68	**140**
Associated and Related Companies – financial and other (note 20)	2	**4**
Total Related Party payables	131	**205**

Related Party receivables and payables have been segregated first between amounts owed by or to Siemens group companies and companies in which the Company has an ownership interest, and second based on the underlying nature of the transactions. Trade receivables and payables include amounts for the purchase and sale of products and services. Financial and other receivables and payables represent amounts owed relating to loans and advances and accrue interest at interbank rates.

The Company and IBM have both extended revolving term loans to ALTIS. As of September 30, 2004 and 2005, the outstanding balance of the Company's loan to ALTIS was €42 and €57, respectively, and is included in current Associated and Related Companies – financial and other receivables as of September 30, 2004, and in non-current Associated and Related Companies – financial and other as of September 30, 2005.

(euro in millions, except where otherwise stated)

Transactions with Related Parties during the years ended September 30, 2003, 2004, and 2005, include the following:

	2003	2004	2005
Sales to Related Parties:			
Siemens group companies	836	957	**861**
Associated and Related Companies	163	69	**55**
Total sales to Related Parties	999	1,026	**916**
Purchases from Related Parties:			
Siemens group companies	413	264	**226**
Associated and Related Companies	470	357	**615**
Total purchases from Related Parties	883	621	**841**
Interest income from (expense to) Related Parties:			
Interest income from Related Parties	4	2	**2**
Interest expense to Related Parties	(1)	–	**–**
Total	3	2	**2**

Sales to Siemens group companies include sales to the Siemens group sales organizations for resale to third parties of €86, €23, and €38 for the years ended September 30, 2003, 2004, and 2005, respectively. Sales are principally conducted through the Company's own independent sales organization directly to third parties. Where the Company has not established its own independent sales organization in a certain country, a commission is paid to the Siemens group sales organizations where they assist in making sales directly to third parties.

Purchases from Siemens group companies primarily include purchases of fixed assets, inventory, IT services, and administrative services.

In February 2004, the Company completed the purchase of assets, including certain liabilities, of the Protocol Software operations of Siemens AG, in exchange for €13 and the employment of approximately 145 of Siemens' mobile communication software engineers.

On August 10, 2000, Siemens issued guaranteed exchangeable notes with an aggregate nominal amount of €2,500. The notes bore a 1% fixed annual interest rate and were to be redeemed by Siemens on August 10, 2005. Each note could be exchanged, in certain circumstances, through July 27, 2005, for 1,000 of the Company's shares. During the year ended September 30, 2004, Siemens repurchased €1,905 of the exchangeable notes and in August 2005 redeemed the remaining €595 notes outstanding at 105.2% of the face value thereof.

On January 12, 2004, Siemens reported that it had sold 150 million shares of Infineon Technologies AG, thereby reducing the shareholding of Siemens Nederland N.V. below the threshold of 10%. As of September 30, 2004, the remaining Siemens interest in the Company of 18.2% was held in a non-voting trust. In November 2004 the trust agreement between the non-voting trust and Siemens AG terminated according to its terms and the 136,292,363 Company shares held pursuant to the trust agreement were transferred to Siemens AG. As of September 30, 2005, the aggregate number of shares beneficially owned by Siemens AG with sole voting and dispositive power was 136,292,363, equaling 18.2% of the Company's issued share capital.

(euro in millions, except where otherwise stated)

28 PENSION PLANS

Pension benefits provided by the Company are currently organized primarily through defined benefit pension plans which cover a significant portion of the Company's employees. Plan benefits are principally based upon years of service. Certain pension plans are based on salary earned in the last year or last five years of employment, while others are fixed plans depending on ranking (both salary level and position). The measurement date for the Company's pension plans is June 30.

Information with respect to the Company's pension plans for the years ended September 30, 2003, 2004, and 2005 is presented for German ("Domestic") plans and non-German ("Foreign") plans:

	2003		2004		2005	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Accumulated benefit obligations end of year	(205)	(52)	(226)	(56)	**(337)**	**(64)**
Change in projected benefit obligations:						
Projected benefit obligations beginning of year	(218)	(58)	(243)	(70)	**(271)**	**(78)**
Service cost	(13)	(5)	(14)	(7)	**(16)**	**(7)**
Interest cost	(13)	(4)	(13)	(4)	**(15)**	**(4)**
Actuarial gains (losses)	3	(5)	–	3	**(89)**	**(2)**
Business combinations	–	(7)	(1)	(1)	**–**	**–**
Divestitures	–	–	1	–	**1**	**4**
New plan created	–	–	–	(2)	**–**	**–**
Plan amendments	(4)	–	(3)	–	**(8)**	**–**
Benefits paid	2	1	2	1	**2**	**2**
Curtailment	–	3	–	–	**4**	**1**
Foreign currency effects	–	5	–	2	**–**	**(1)**
Projected benefit obligations end of year	(243)	(70)	(271)	(78)	**(392)**	**(85)**
Change in fair value of plan assets:						
Fair value at beginning of year	120	26	143	27	**174**	**30**
Contributions and transfers	22	2	19	2	**17**	**4**
Actual return on plan assets	3	–	14	3	**19**	**2**
Benefits paid	(2)	(1)	(2)	(1)	**(2)**	**(2)**
Business combination	–	4	–	–	**–**	**–**
New plan created	–	–	–	–	**–**	**–**
Foreign currency effects	–	(4)	–	(1)	**–**	**1**
Fair value at end of year	143	27	174	30	**208**	**35**
Funded status	(100)	(43)	(97)	(48)	**(184)**	**(50)**
Unrecognized actuarial loss	66	6	59	2	**138**	**4**
Unrecognized prior service cost (benefit)	4	(2)	7	(2)	**14**	**(2)**
Post measurement date contributions	16	–	1	1	**16**	**1**
Net liability recognized	(14)	(39)	(30)	(47)	**(16)**	**(47)**

The above net liability is recognized as follows in the accompanying consolidated balance sheets as of September 30:

	2003		2004		2005	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Prepaid pension cost (note 17)	–	1	27	–	**–**	**–**
Intangible asset (note 14)	4	–	–	–	**14**	**–**
Accumulated other comprehensive income	29	–	–	–	**85**	**–**
Accrued pension liabilities (note 22)	(47)	(40)	(51)	(47)	**(115)**	**(47)**
Other current liabilities	–	–	(6)	–	**–**	**–**
Net liability recognized	(14)	(39)	(30)	(47)	**(16)**	**(47)**

(euro in millions, except where otherwise stated)

Other current liabilities of €6 at September 30, 2004, related to pension liabilities of the fiber optic business which was held for sale.

Information for pension plans with projected benefit obligations and accumulated benefit obligations in excess of plan assets are as follows:

	2003		2004		2005	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Projected benefit obligation	243	70	271	78	**393**	**85**
Fair value of plan assets	143	27	174	30	**208**	**35**
Accumulated benefit obligations	205	48	53	51	**337**	**57**
Fair value of plan assets	143	22	–	23	**208**	**26**

The weighted-average assumptions used in calculating the actuarial values for the pension plans are as follows:

	2003		2004		2005	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Discount rate in %	5.8	5.9	5.8	5.6	**4.5**	**4.8**
Rate of compensation increase in %	3.0	3.9	3.0	3.7	**2.5**	**3.1**
Projected future pension increases in %	1.3	2.6	1.3	2.6	**1.3**	**2.2**
Expected return on plan assets in %	4.9	6.8	6.8	7.0	**7.3**	**6.9**

Discount rates are established based on prevailing market rates for high-quality fixed-income instruments that, if the pension benefit obligation were settled at the measurement date, would provide the necessary future cash flows to pay the benefit obligation when due. The Company believes short-term changes in interest rates should not affect the measurement of the Company's long-term obligation.

Investment strategies

The investment approach of the Company's pension plans involves employing a sufficient level of flexibility to capture investment opportunities as they occur, while maintaining reasonable parameters to ensure that prudence and care are exercised in the execution of the investment program. The Company's pension plans' assets are invested with several investment managers. The plans employ a mix of active and passive investment management programs. Considering the duration of the underlying liabilities, a portfolio of investments of plan assets in equity securities, debt securities, and other assets is targeted to maximize the long-term return on assets for a given level of risk. Investment risk is monitored on an ongoing basis through periodic portfolio reviews, meetings with investment managers, and annual liability measurements. Investment policies and strategies are periodically reviewed to ensure the objectives of the plans are met considering any changes in benefit plan design, market conditions, or other material items.

Expected long-term rate of return on plan assets

Establishing the expected rate of return on pension assets requires judgment. The Company's approach in determining the long-term rate of return for plan assets is based upon historical financial market relationships that have existed over time, the types of investment classes in which pension plan assets are invested, long-term investment strategies, as well as the expected compounded return the Company can reasonably expect the portfolio to earn over appropriate time periods.

The Company reviews the expected long-term rate of return annually and revises it as appropriate. Also, the Company periodically commissions detailed asset/liability studies to be performed by third-party professional investment advisors and actuaries.

(euro in millions, except where otherwise stated)

Plan asset allocation

As of September 30, 2004 and 2005, the percentage of plan assets invested and the targeted allocation in major asset categories are as follows:

	2004		2005		Targeted allocation	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Equity securities in %	45	60	**44**	**57**	45	59
Debt securities in %	46	38	**51**	**35**	52	35
Other in %	9	2	**5**	**8**	3	6
Total in %	100	100	**100**	**100**	100	100

The Company's asset allocation targets for its pension plan assets are based on its assessment of business and financial conditions, demographic and actuarial data, funding characteristics, related risk factors, market sensitivity analysis, and other relevant factors. The overall allocation is expected to help protect the plans' funded status while generating sufficiently stable real returns (i.e., net of inflation) to meet current and future benefit payment needs. Due to active portfolio management, the asset allocation may differ from the target allocation up to certain limits for different classes. As a matter of policy, the Company's pension plans do not invest in the Company's shares.

The components of net periodic pension cost for the years ended September 30, 2003, 2004, and 2005 are as follows:

	2003		2004		2005	
	Domestic plans	Foreign plans	Domestic plans	Foreign plans	Domestic plans	Foreign plans
Service cost	(13)	(5)	(14)	(7)	**(16)**	**(7)**
Interest cost	(13)	(4)	(13)	(4)	**(15)**	**(4)**
Expected return on plan assets	6	2	11	2	**13**	**2**
Amortization of unrecognized losses	(3)	–	(3)	–	**(3)**	**–**
Curtailment gain recognized	–	3	–	–	**1**	**1**
Net periodic pension cost (note 7)	(23)	(4)	(19)	(9)	**(20)**	**(8)**

The prior service costs relating to the pension plans are amortized in equal amounts over the expected years of future service of each active employee who is expected to receive benefits from the pension plans.

Unrecognized gains or losses are included in the net pension cost for the year if, as of the beginning of the year, the unrecognized net gains or losses exceed 10% of the greater of the projected benefit obligation or the market value of the plan assets. The amortization is the excess divided by the average remaining service period of active employees expected to receive benefits under the plan.

Actuarial gains (losses) amounted to €(2), €3 and €(91) for the years ended September 30, 2003, 2004, and 2005, respectively. The increase in actuarial losses in the 2005 financial year was primarily the result of the reduction of the discount rate used to determine the benefit obligation and new mortality tables used in the actuarial calculations for the domestic plans.

On September 25, 2000, the Company established the Infineon Technologies Pension Trust e.V. (the "Pension Trust") for the purpose of funding future pension benefit payments for employees in Germany in order to reduce the Company's exposure to certain risks associated with defined benefit plans. The Company contributed €155 of cash and marketable debt and equity securities, which qualify as plan assets under SFAS No. 87 "Employers' Accounting for Pensions", to the Pension Trust for use in funding these pension benefit obligations, thereby reducing accrued pension liabilities.

(euro in millions, except where otherwise stated)

The effect of employee terminations, in connection with the Company's restructuring plans (see note 8), on the Company's pension obligation is reflected as a curtailment in the years ended September 30, 2003 and 2005, pursuant to the provisions of SFAS No. 88 "Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits".

The future benefit payments, which reflect future service, as appropriate, that are expected to be paid from the Company's pension plan for the next five financial years and thereafter are as follows:

Years ending September 30	Domestic plans	Foreign plans
2006	7	1
2007	7	1
2008	8	2
2009	10	2
2010	13	2
2011–2015	77	18

During the year ended September 30, 2002, the Company established a deferred savings plan for its German employees, whereby a portion of the employee's salary is invested for a lump sum benefit payment including interest upon retirement. The liability for such future payments of €9 and €14 as of September 30, 2004 and 2005, respectively, is actuarially determined and accounted for on the same basis as the Company's other pension plans.

The Company provides post-retirement health care benefits to eligible employees in the United States. The Company recognized net periodic benefit cost of less than €1 for each of the years ended September 30, 2003, 2004, and 2005. The net liability recognized in the accompanying balance sheet was €5 as of September 30, 2004 and 2005.

29 FINANCIAL INSTRUMENTS

The Company periodically enters into derivatives, including foreign currency forward and option contracts as well as interest rate swap agreements. The objective of these transactions is to reduce the impact of interest rate and exchange rate fluctuations on the Company's foreign currency denominated net future cash flows. The Company does not enter into derivatives for trading or speculative purposes.

The euro equivalent notional amounts in millions and fair values of the Company's derivative instruments as of September 30, 2004 and 2005, are as follows:

	2004		2005	
	Notional amount	Fair value	Notional amount	Fair value
Forward contracts sold:				
U.S. dollar	371	8	**838**	**(20)**
Japanese yen	4	–	**9**	**–**
Singapore dollar	–	–	**2**	**–**
Forward contracts purchased:				
U.S. dollar	56	(1)	**195**	**4**
Japanese yen	55	–	**42**	**–**
Singapore dollar	29	–	**23**	**–**
Great Britain pound	4	–	**5**	**–**
Czech Koruna	–	–	**1**	**–**
Malaysian Ringgit	–	–	**32**	**1**
Other currencies	5	–	**23**	**(1)**
Currency Options sold:				
U.S. dollar	520	(16)	**527**	**(21)**
Currency Options purchased:				
U.S. dollar	514	9	**522**	**3**
Cross currency interest rate swap:				
U.S. dollar	406	60	**389**	**21**
Interest rate swaps	1,442	29	**1,442**	**14**
Other	–	–	**259**	**(2)**
Fair value, net		89		**(1)**

During the year ended September 30, 2004, the Company designated two interest rate swap agreements with a total notional amount of €500, as fair value hedges of a corresponding principal amount of its convertible notes due 2007. The change in fair value of these hedges during the years ended September 30, 2004 and 2005, were €1 and €(5), respectively, and was reflected as part of interest expense. During the fourth quarter of the 2005 financial year the Company de-designated those fair value hedges. The change in fair value since inception of the hedge of €(4) will be amortized into interest expense over the remaining term of the convertible notes.

The Company entered into interest rate swap agreements with independent financial institutions, which are designated as a cash flow hedge of interest rate fluctuations on forecasted future lease payments during the first 10 years of the Campeon lease agreement (see note 31). The ineffective portion of the cash flow hedge was €0 for the years ended September 30, 2004 and 2005. The effective portion of €1 and €(24) is deferred in other comprehensive income and is expected to be reclassified ratably into earnings as part of the lease expense, from the commencement of the lease, over the relevant period of the lease term.

Interest expense, net, was partially offset by gains resulting from interest rate swap agreements in the amount of €11, €22, and €21 for the years ended September 30, 2003, 2004, and 2005, respectively.

Gains and losses on derivative financial instruments included in determining net income (loss), with those related to operations included primarily in cost of goods sold, and those related to financial activities included in other non-operating income (expense), were as follows for the years ended September 30:

	2003	2004	2005
Gains (losses) from foreign currency derivatives:			
Cost of sales	8	44	**(14)**
Other non-operating (expense) income	106	3	**(10)**
	114	47	**(24)**
Gains (losses) from foreign currency transactions:			
Cost of sales	(40)	(50)	**(5)**
Other non-operating (expense) income	(106)	(12)	**50**
	(146)	(62)	**45**
Net gains (losses) from foreign currency derivatives and transactions	(32)	(15)	**21**

Fair values of financial instruments are determined using quoted market prices or discounted cash flows. The fair value of the Company's unsecured term loans and interest-bearing notes payable approximate their carrying values as their interest rates approximate those which could be obtained currently. At September 30, 2005, the convertible notes due 2007 and the convertible notes due 2010 were trading at a 1.2% and a 9.4% premium to par, respectively, based on quoted market values.

The fair values of the Company's cash and cash equivalents, receivables, related-party receivables and payables, and other financial instruments approximated their carrying values due to their short-term nature. Marketable securities are recorded at fair value (see note 11).

30 RISKS

Financial instruments that expose the Company to credit risk consist primarily of trade receivables, cash equivalents, marketable securities, and financial derivatives. Concentrations of credit risks with respect to trade receivables are limited by the large number of geographically diverse customers that make up the Company's customer base. The Company controls credit risk through credit approvals, credit limits, and monitoring procedures, as well as comprehensive credit evaluations for all customers. Related Parties account for a considerable portion of sales and trade receivables. The credit risk with respect to cash equivalents, marketable securities and financial derivatives is limited by transactions with a number of large international financial institutions, with pre-established limits. The Company does not believe that there is significant risk of non-performance by these counterparties because the Company monitors their credit risk and limits the financial exposure and the amounts of agreements entered into with any one financial institution.

In order to remain competitive, the Company must continue to make substantial investments in process technology and research and development. Portions of these investments might not be recoverable if these research and development efforts fail to gain market acceptance or if markets significantly deteriorate.

Due to the high-technology nature of the Company's operations, intellectual property is an integral part of the Company's business. The Company has intellectual property which it has self-developed, purchased or licensed from third parties. The Company is exposed to infringements by others of such intellectual property rights. Conversely, the Company is exposed to assertions by others of infringement by the Company of their intellectual property rights.

The Company, through its use of third-party foundry and joint venture arrangements, uses a significant portion of manufacturing capacity that is outside of its direct control. As a result, the Company is reliant upon such other parties for the timely and uninterrupted supply of products and is exposed, to a certain extent, to fluctuations in product procurement cost.

(euro in millions, except where otherwise stated)

The Company has established policies and procedures which serve as business conduct guidelines for its employees. Should these guidelines not be adhered to, the Company could be exposed to risks relating to wrongful actions by its employees.

Approximately 10,000 of the Company's employees are covered by collective bargaining agreements. The collective bargaining agreements pertain primarily to certain of the Company's non-management employees in Germany (affecting approximately 6,400 employees), the Czech Republic (affecting approximately 400 employees) and Austria (affecting approximately 2,300 employees). The agreement in Germany is perpetual, but can be terminated by the trade union with a notice of one month prior to February 28, 2006. The agreement in Austria expires on May 1, 2006. The provisions of these agreements generally remain in effect until replaced by a subsequent agreement. Agreements for periods after expiration are to be negotiated with the respective trade unions through a process of collective negotiations.

31 COMMITMENTS AND CONTINGENCIES

Litigation

In March 2005, the Company and Rambus reached an agreement settling all claims between them and licensing the Rambus patent portfolio for use in current and future Company products. Rambus has granted to the Company a worldwide license to existing and future Rambus patents and patent applications for use in its memory products. In exchange for this worldwide license, the Company agreed to pay $50 million in quarterly installments of $6 million from November 15, 2005, through November 15, 2007. After November 15, 2007, and only if Rambus enters into additional specified licensing agreements with certain other DRAM manufacturers, the Company will make additional quarterly payments which may aggregate a maximum of an additional $100 million. The agreement also provides the Company an option for acquiring certain other licenses. All licenses provide for the Company to be treated as a "most-favored customer" of Rambus. The Company simultaneously granted to Rambus a fully-paid perpetual license for memory interfaces.

On May 7, 2003, ProMOS filed arbitration proceedings against the Company, seeking payment of approximately $36 million for DRAM products sold to the Company, damages in the amount of approximately $338 million for non-delivery of technology and an affirmative judgment that ProMOS be allowed to continue to use the technology already transferred by the Company. The Company filed counterclaims seeking a judgment that ProMOS be required to cease using the Company's technology and pay damages of approximately $568 million, after deduction of $36 million for DRAM products sold to the Company.

On November 10, 2004, the Company and ProMOS reached an agreement regarding ProMOS' license of the Company's DRAM technology transferred to ProMOS. The S17 to S12 License Agreement of 2000 was amended and remains in effect. ProMOS has been, and continues to be, licensed to produce and sell products using the technology transferred by the Company, and to develop its own processes and products. As full consideration for the ongoing license for use of the Company's technology, ProMOS agreed to pay the Company $156 million in four installments over a period through April 30, 2006, against which the Company's accrued payable for DRAM products purchased from ProMOS of $36 million was offset. All claims (including litigation, arbitration or other complaints) raised by both sides have been withdrawn. The Company recognized the relevant license income in the first quarter of the 2005 financial year.

In September 2004, the Company entered into a plea agreement with the Antitrust Division of the U.S. Department of Justice ("DOJ") in connection with its ongoing investigation of alleged antitrust violations in the DRAM industry. Pursuant to this plea agreement, the Company agreed to plead guilty to a single count related to the pricing of DRAM products between July 1, 1999, and June 15, 2002. Under the terms of the agreement, the Company agreed to pay a fine of $160 million. The fine plus accrued interest is to be paid in equal annual installments through 2009. On October 25, 2004, the plea agreement was accepted by the U.S. District Court for the Northern District of California. Therefore, the matter has been fully resolved between the Company and the DOJ, subject to the Company's obligation to cooperate with the DOJ in its ongoing investigation of other participants in the DRAM industry. The wrongdoing charged by the DOJ was limited to six Original Equipment Manufacturer ("OEM") customers that manufacture computers and servers. The Company has entered into settlement agreements with five of these OEM customers and is considering the possibility of a settlement with the remaining OEM customer, which purchased only a very small volume of DRAM products from the Company.

Subsequent to the commencement of the DOJ investigation, a number of purported class action lawsuits were filed against the Company, its U.S. subsidiary, and other DRAM suppliers.

Sixteen cases were filed between June 2002 and September 2002 in the following U.S. federal district courts: one in the Southern District of New York, five in the District of Idaho, and 10 in the Northern District of California. Each of the federal district court cases purports to be on behalf of a class of individuals and entities who purchased DRAM directly from various DRAM suppliers in the United States of America during a specified time period commencing on or after October 1, 2001 ("Direct U.S. Purchaser Class"). The complaints allege price-fixing in violation of the Sherman Act and seek treble damages in unspecified amounts, costs, attorneys' fees, and an injunction against the allegedly unlawful conduct. In September 2002, the Judicial Panel on Multi-District Litigation held a hearing and subsequently ordered that the foregoing federal cases be transferred to the U.S. District Court for the Northern District of California (San Francisco) for coordinated or consolidated pretrial proceedings as part of a Multi-District Litigation ("MDL"). In June 2005, with the permission of the U.S. District Court for the Northern District of California, the plaintiffs filed a second amended complaint alleging that the unlawful conduct commenced on approximately April 1, 1999, and continued through at least June 30, 2002. The Company has reached a settlement agreement with the Direct U.S. Purchaser Class (subject to approval by the U.S. District Court for the Northern District of California) and has secured individual settlements with seven direct customers in addition to those OEMs identified by the DOJ.

Sixty-three additional cases were filed between August 2, 2002, and September 16, 2005, in numerous federal and state courts throughout the United States of America. Each of these state and federal cases (except a case filed in the U.S. District Court for the Eastern District of Pennsylvania) purports to be on behalf of a class of individuals and entities who indirectly purchased DRAM in the United States of America during specified time periods commencing in or after 1999 ("Indirect U.S. Purchaser Class"). The Eastern District of Pennsylvania case purports to be on behalf of a class of foreign individuals and entities who directly purchased DRAM outside of the United States of America between April 1999 and June 2000 ("Direct Foreign Purchaser Class"). The complaints variously allege violations of the Sherman Act, California's Cartwright Act, various other state laws, unfair competition law, and unjust enrichment, and seek treble damages in unspecified amounts, restitution, costs, attorneys' fees, and an injunction against the allegedly unlawful conduct. In response to a petition filed by one of the plaintiffs, a judge appointed by the Judicial Council of California subsequently ordered that the then-pending California state cases be coordinated for pretrial purposes and recommended that they be transferred to San Francisco County Superior Court for coordinated or consolidated pretrial proceedings. Subsequently 12 of the state court cases and the U.S. District Court for the Eastern District of Pennsylvania case were ordered transferred to the U.S. District Court for the Northern District of California (San Francisco) for coordinated and consolidated pretrial proceedings as part of the MDL described above. After this transfer, the plaintiffs dismissed two of the transferred state court cases. Two additional transferred state court cases were subsequently remanded back to their relevant state courts. The Company is defending against these actions vigorously.

In April 2003, the Company received a request for information from the European Commission (the "Commission") to enable the Commission to assess the compatibility with the Commission's rules on competition of certain practices of which the Commission has become aware in the European market for DRAM products. The Company has reassessed the matter after its plea agreement with the DOJ and made an accrual during the 2004 financial year for a probable minimum fine that may be imposed as a result of the Commission's investigation. Any fine actually imposed by the Commission may be significantly higher than the reserve established, although the Company cannot more accurately estimate the amount of such actual fine. The Company is fully cooperating with the Commission in its investigation.

In May 2004, the Canadian Competition Bureau advised the Company's U.S. subsidiary that it and its affiliated companies are among the targets of a formal inquiry into alleged violations of the Canadian Competition Act in the DRAM industry. No compulsory process (such as subpoenas) has been commenced. The Company is cooperating with the Competition Bureau in its inquiry.

In October 2004, a proposed class proceeding was commenced against the Company in the Canadian province of Quebec on behalf of indirect purchasers, who purchased products in Quebec from certain OEM customers which contained DRAM during the period from July 1999 to June 2002, seeking damages in unspecified amounts, investigation costs, interest, and legal costs in respect of activities which are the subject of the Company's September 15, 2004, plea agreement with the DOJ. In the period from December 2004 to February 2005, three other proposed class proceedings were commenced in the provinces of Ontario, Quebec and British Columbia on behalf of all direct and indirect purchasers resident, respectively, in Canada (in the case commenced in the province of Ontario), the province of Quebec and British Columbia, who purchased DRAM or products

which contained DRAM during the period from July 1999 to June 2002, seeking damages, punitive damages, investigation and administration costs, in unspecified amounts, interest, and legal costs.

Between September 30, 2004, and November 4, 2004, a total of seven securities class action complaints were filed against the Company in the U.S. District Courts for the Northern District of California and the Southern District of New York. The plaintiffs voluntarily dismissed the New York cases, and on June 30, 2005, filed a Consolidated Amended Complaint in California, effectively consolidating all the lawsuits. The Consolidated Amended Complaint alleges violations of the U.S. federal securities laws and seeks damages on behalf of a purported class of purchasers of the Company's publicly traded securities during the period from March 13, 2000, to July 19, 2004. The Company is vigorously defending against allegations of U.S. securities laws violations.

In late 2002, MOSAID Technologies Inc. ("MOSAID") alleged that the Company was violating 11 DRAM-related U.S. patents of MOSAID. In December 2002, the Company filed an action in the U.S. District Court for the Northern District of California seeking a declaratory judgment that the Company was not violating such patents. On February 7, 2003, MOSAID filed a counter-suit opposing the Company's motion for declaratory judgment and seeking damages for the alleged patent infringement. On November 3, 2003, MOSAID announced that it had filed an amended counterclaim to add two new patents to its previous claims. This matter has since been consolidated under the federal multidistrict litigation rules with another lawsuit filed by MOSAID against Samsung Electronics Co. Ltd. ("Samsung") in the U.S. District Court for the District of New Jersey. On April 1, 2005, the U.S. District Court issued a summary judgment order that the Company's products did not infringe most of MOSAID's asserted claims, leaving the infringement of only two claims in one patent still to be determined. A trial date for these claims has not yet been scheduled. On April 6, 2005, MOSAID filed an additional lawsuit in the U.S. District Court for the Eastern District of Texas, alleging that the Company's DRAM products infringe one or more claims of three MOSAID patents. A trial on this issue has been scheduled for October 2006. The Company intends to vigorously defend against MOSAID's claims.

On March 5, 2005, Tessera Technologies, Inc. ("Tessera") filed a lawsuit in the U.S. District Court for the Eastern District of Texas, alleging that the Company's products containing ball grid array packages infringe five Tessera patents. On April 13, 2005, Tessera amended its complaint to allege that the Company and Micron violated U.S. antitrust law, Texas unfair competition law, and Texas business tort law by conspiring to harm the sale of Rambus' RDRAM chips, thereby injuring Tessera's ability to sell chip packaging for RDRAM chips. A trial has been scheduled for August 2006. The Company intends to vigorously defend against Tessera's claims.

Liabilities related to legal proceedings are recorded when it is probable that a liability has been incurred and the associated amount can be reasonably estimated. Where the estimated amount of loss is within a range of amounts and no amount within the range is a better estimate than any other amount or the range cannot be estimated, the minimum amount is accrued. As of September 30, 2005, the Company had accrued liabilities in the amount of €144 related to the antitrust investigations and related antitrust and securities civil claims described above. As additional information becomes available, the potential liability related to these matters will be reassessed and the estimates revised, if necessary. These accrued liabilities would be subject to change in the future based on new developments in each matter, or changes in circumstances, which could have a material adverse effect on the Company's results of operations, financial position, and cash flows.

An adverse final resolution of the antitrust investigations or related civil claims or the securities class action lawsuits described above could result in substantial financial liability to, and other adverse effects upon the Company, which would have a material adverse effect on its business, results of operations, and financial condition. Irrespective of the validity or the successful assertion of the above-referenced claims, the Company could incur significant costs with respect to defending against or settling such claims, which could have a material adverse effect on its results of operations, financial position, and cash flows.

An adverse final resolution in the MOSAID or Tessera lawsuits could result in significant financial liabilities to, and other adverse effects upon the Company, which would have a material adverse effect on the Company's results of operations, financial position, and cash flows.

The Company is subject to various other lawsuits, legal actions, claims and proceedings related to products, patents and other matters incidental to its businesses. The Company has accrued a liability for the estimated costs of adjudication of various asserted and unasserted claims existing as of the balance sheet date. Based upon information presently known to management, the Company does not believe that the ultimate

resolution of such other pending matters will have a material adverse effect on the Company's financial position, although the final resolution of such matters could have a material adverse effect on the Company's results of operations or cash flows in the year of settlement.

In connection with the Company's formation, Siemens retained certain facilities located in the U.S. and certain related environmental liabilities. Businesses contributed to the Company by Siemens historically conducted operations at certain of these facilities and, under applicable law, could be required to contribute to the environmental remediation of these facilities despite their retention by Siemens. Siemens has provided guarantees to certain third parties and governmental agencies, and all involved parties have recognized Siemens as the responsible party for all applicable sites. No assessments have been made of the extent of environmental remediation, if any, that could be required, and no claims have been made against the Company in this regard. The Company believes its potential exposure, if any, to liability for remediating the U.S. facilities retained by Siemens is therefore low.

Contractual commitments

The following table summarizes the Company's commitments with respect to external parties as of September 30, 2005[1, 2]:

Payments due by period	Total	Less than 1 year	1–2 years	2–3 years	3–4 years	4–5 years	After 5 years
Contractual commitments:							
Operating lease payments	**850**	94	71	61	56	54	514
Unconditional purchase commitments	**1,505**	1,379	45	24	9	9	39
Other long-term commitments	**138**	46	46	46	–	–	–
Total commitments	**2,493**	1,519	162	131	65	63	553

1 Certain payments of obligations or expirations of commitments that are based on the achievement of milestones or other events that are not date-certain are included for purposes of this table based on estimates of the reasonably likely timing of payments or expirations in the particular case. Actual outcomes could differ from those estimates.

2 Product purchase commitments associated with continuing capacity reservation agreements are not included in this table, since the purchase prices are based, in part, on future market prices, and are accordingly not accurately quantifiable at September 30, 2005. Purchases under these arrangements aggregated approximately €950 for the year ended September 30, 2005.

In December 2002, the Company and Semiconductor Manufacturing International Corporation ("SMIC") entered into a technology transfer and capacity reservation agreement. In exchange for the technology transfer, SMIC will reserve specified capacity over a five-year period, with product purchases based on a market price formula. In 2004 the parties amended their agreement to include next generation technology.

On July 28, 2003, the Company entered into a joint venture agreement with China-Singapore Suzhou Industrial Park Venture Company ("CSVC") for the construction of a back-end manufacturing facility in the People's Republic of China. The capital invested by CSVC earns an annual return and has a liquidation preference. All accumulated earnings and dividend rights accrue to the benefit of the Company. Accordingly, the Company has consolidated 100% of the results of operations of the joint venture from inception.

The Company has capacity reservation agreements with certain Associated Companies and external foundry suppliers for the manufacturing and testing of semiconductor products. These agreements generally are greater than one year in duration and are renewable. Under the terms of these agreements, the Company has agreed to purchase a portion of their production output based, in part, on market prices.

Purchases under these agreements are recorded as incurred in the normal course of business. The Company assesses its anticipated purchase requirements on a regular basis to meet customer demand for its products. An assessment of losses under these agreements is made on a regular basis in the event that either budgeted purchase quantities fall below the specified quantities or market prices for these products fall below the specified prices.

(euro in millions, except where otherwise stated)

Other contingencies

The following table summarizes the Company's contingencies with respect to external parties, other than those related to litigation, as of September 30, 2005[1]:

Expirations by period	Total	Less than 1 year	1–2 years	2–3 years	3–4 years	4–5 years	After 5 years
Maximum potential future payments:							
Guarantees	**462**	99	204	23	5	–	131
Contingent government grants[2]	**516**	67	101	128	42	55	123
Total contingencies	**978**	166	305	151	47	55	254

1 Certain expirations of contingencies that are based on the achievement of milestones or other events that are not date-certain are included for purposes of this table based on estimates of the reasonably likely timing of expirations in the particular case. Actual outcomes could differ from those estimates.
2 Contingent government grants refer to amounts previously received, related to the construction and financing of certain production facilities, which are not otherwise guaranteed and could be refundable if the total project requirements are not met.

The Company has guarantees outstanding to external parties of €462 as of September 30, 2005. In addition, the Company, as parent company, has in certain customary circumstances guaranteed the settlement of certain of its consolidated subsidiaries' obligations to third parties. Such obligations are reflected as liabilities in the consolidated financial statements by virtue of consolidation. As of September 30, 2005, such inter-company guarantees, principally relating to certain consolidated subsidiaries' third-party debt, aggregated €1,604, of which €1,340 relates to convertible notes issued.

The Company has received government grants and subsidies related to the construction and financing of certain of its production facilities. These amounts are recognized upon the attainment of specified criteria. Certain of these grants have been received contingent upon the Company maintaining compliance with certain project-related requirements for a specified period after receipt. The Company is committed to maintaining these requirements. Nevertheless, should such requirements not be met as of September 30, 2005, a maximum of €516 of these subsidies could be refundable.

On December 23, 2003, the Company entered into a long-term operating lease agreement with MoTo Objekt Campeon GmbH & Co. KG ("MoTo") to lease an office complex constructed by MoTo south of Munich, Germany. The office complex, called Campeon, will enable the Company to centralize the majority of its Munich-area employees, who are currently situated in various locations throughout Munich, in one central physical working environment. MoTo is responsible for the construction, which was completed in the second half of 2005. The Company has no obligations with respect to financing MoTo, and has provided no guarantees related to the construction. The Company occupied Campeon under an operating lease arrangement in October 2005 and has begun the gradual move of employees to this new location. The complex was leased for a period of 20 years. After year 15, the Company has a non-bargain purchase option to acquire the complex or otherwise continue the lease for the remaining period of five years. Pursuant to the agreement, the Company placed a rental deposit of €75 in escrow, which was included in restricted cash as of September 30, 2005, and could not be utilized by the lessor prior to occupation. Lease payments are subject to limited adjustment based on specified financial ratios related to the Company. The agreement will be accounted for as an operating lease, in accordance with SFAS No. 13, with monthly lease payments expensed on a straight-line basis over the lease term.

The Company, through certain of its sales and other agreements, may, in the normal course of business, be obligated to indemnify its counterparties under certain conditions for warranties, patent infringement, or other matters. The maximum amount of potential future payments under these types of agreements is not predictable with any degree of certainty, since the potential obligation is contingent on conditions that may or may not occur in future, and depends on specific facts and circumstances related to each agreement. Historically, payments made by the Company under these types of agreements have not had a material adverse effect on the Company's business, results of operations, or financial condition.

(euro in millions, except where otherwise stated)

A tabular reconciliation of the changes in the aggregate product warranty liability for the year ended September 30, 2005, is as follows:

	2005
Balance as of October 1, 2004	**68**
Accrued during the year, net	**33**
Settled during the year	**(51)**
Balance as of September 30, 2005	**50**

32 OPERATING SEGMENT AND GEOGRAPHIC INFORMATION

The Company has reported its operating segment and geographic information in accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information".

Effective January 1, 2005, the Company simplified its organization to create shorter and faster decision paths across the entire Company, a stronger customer orientation, as well as greater efficiency and flexibility. The Mobile business and Wireline Communication segment have been combined into the new Communication segment to align the Company's structure with market developments. At the same time, the security and chip card activities and the ASIC & Design Solutions business have been integrated into the extended Automotive, Industrial and Multimarket segment. The segments' financial position and results of operations of prior years have been reclassified to be consistent with the revised reporting structure and presentation, as well as to facilitate analysis of current and future operating segment information.

As a result, the Company now operates primarily in three major operating segments, two of which are application-focused: Automotive, Industrial and Multimarket, and Communication; and one of which is product focused: Memory Products. Further, certain of the Company's remaining activities for product lines sold, for which there are no continuing contractual commitments subsequent to the divestiture date, as well as new business activities, also meet the SFAS No. 131 definition of an operating segment, but do not meet the requirements of a reportable segment as specified in SFAS No. 131. Accordingly, these segments are combined and disclosed in the "Other Operating Segments" category pursuant to SFAS No. 131.

The accounting policies of the segments are substantially the same as described in the summary of significant accounting policies (see note 2). Each of the segments has a segment manager reporting directly to the Chief Executive Officer and Chief Financial Officer, who have been collectively identified as the Chief Operating Decision Maker ("CODM"). The CODM makes decisions about resources to be allocated to the segments and assesses their performance using revenues and EBIT. The CODM does not review asset information by segment, nor does he evaluate the segments on these criteria on a regular basis, except that the CODM is provided information regarding certain inventories on an operating segment basis. The Company does, however, allocate depreciation expense to the operating segments based on production volume and product mix using standard costs. Information with respect to the Company's operating segments follows:

Automotive, Industrial and Multimarket

The Automotive, Industrial and Multimarket segment designs, develops, manufactures, and markets semiconductors and complete system solutions for use in automotive, industrial, and multimarket applications.

Communication

The Communication segment designs, develops, manufactures, and markets a wide range of ICs, other semiconductors, and complete system solutions for wireline and wireless communication applications.

Memory Products

The Memory Products segment designs, develops, manufactures, and markets semiconductor memory products with various packaging and configuration options and performance characteristics for standard, specialty, and embedded memory applications.

Other Operating Segments

Remaining activities for certain product lines that have been disposed of, as well as other business activities, are included in the Other Operating Segments.

(euro in millions, except where otherwise stated)

Selected segment data for the years ended September 30, 2003, 2004, and 2005 is as follows:

	2003	2004	2005
Net sales:			
Automotive, Industrial and Multimarket	2,186	2,540	**2,516**
Communication	1,428	1,689	**1,391**
Memory Products	2,485	2,926	**2,826**
Other Operating Segments	21	11	**12**
Corporate and Reconciliation	32	29	**14**
Total	6,152	7,195	**6,759**

	2003	2004	2005
EBIT:			
Automotive, Industrial and Multimarket	148	252	**134**
Communication	(213)	(44)	**(295)**
Memory Products	31	169	**122**
Other Operating Segments	(50)	(75)	**(4)**
Corporate and Reconciliation	(215)	(46)	**(140)**
Total	(299)	256	**(183)**

	2003	2004	2005
Depreciation and amortization:			
Automotive, Industrial and Multimarket	356	398	**400**
Communication	305	232	**185**
Memory Products	768	683	**724**
Other Operating Segments	8	7	**7**
Corporate and Reconciliation	–	–	**–**
Total	1,437	1,320	**1,316**

	2003	2004	2005
Equity in earnings (losses) of Associated Companies:			
Automotive, Industrial and Multimarket	–	–	**–**
Communication	4	5	**4**
Memory Products	22	(16)	**54**
Other Operating Segments	(1)	(4)	**(2)**
Corporate and Reconciliation	(7)	1	**1**
Total	18	(14)	**57**

	2003	2004	2005
Inventories:			
Automotive, Industrial and Multimarket	332	359	**336**
Communication	209	266	**201**
Memory Products	415	334	**484**
Other Operating Segments	3	1	**1**
Corporate and Reconciliation	–	–	**–**
Total	959	960	**1,022**

Goodwill at September 30, 2004 and 2005, is reflected in the following segments:

	2004	2005
Goodwill:		
Automotive, Industrial and Multimarket	13	**–**
Communication	51	**27**
Memory Products	81	**88**
Other Operating Segments	6	**8**
Corporate and Reconciliation	–	**2**
Total	151	**125**

Due to the organizational structure of the operating segments, there are currently no sales transactions between operating segments. Accordingly, net sales by operating segment represent sales to external customers.

As of September 30, 2003 and 2004, raw material and work-in-process of certain common logic production front-end facilities, and work-in-process of the common back-end facilities, were not under the direct control or responsibility of any of the operating segment managers, but rather of the site management. The site management was responsible for the execution of the production schedule, volume, and units. Accordingly, this inventory was not attributed to any operating segment, but was included in the "Corporate and Reconciliation" column. Only unstarted wafers of the back-end facilities ("chip stock") and finished goods were attributable to the operating segments and included in the segment information reported to the CODM. As of September 30, 2005, all inventory was attributed to the respective operating segment, since it was under the direct control and responsibility of the respective operating segment managers. Prior periods have been reclassified to conform to the current year presentation.

(euro in millions, except where otherwise stated)

Certain items are included in Corporate and Reconciliation and are not allocated to the segments, consistent with the Company's internal management reporting. These include certain corporate headquarters' costs, certain incubator and early stage technology investment costs, non-recurring gains and specific strategic technology initiatives. Additionally, restructuring charges are included in corporate and reconciliation and not allocated to the segments for internal or external reporting purposes, since they arise from corporate directed decisions not within the direct control of segment management. Furthermore, legal costs associated with intellectual property and product matters are recognized by the segments when paid, which can differ from the period originally recognized by corporate and reconciliation. The Company allocates excess capacity costs based on a foundry model, whereby such allocations are reduced based upon the lead time of order cancellation or modification. Any unabsorbed excess capacity costs are included in corporate and reconciliation. Significant components of corporate and reconciliation EBIT for the years ended September 30, 2003, 2004, and 2005 are as follows:

	2003	2004	2005
Corporate and Reconciliation:			
Unabsorbed excess capacity costs	(101)	(34)	**(12)**
Restructuring charges	(29)	(17)	**(78)**
Corporate information technology development costs	(13)	–	**–**
Other, net	(72)	5	**(50)**
Total	(215)	(46)	**(140)**

The following is a summary of net sales and of property, plant and equipment by geographic area for the years ended September 30:

	2003	2004	2005
Net sales:			
Germany	1,535	1,675	**1,354**
Other Europe	1,112	1,263	**1,210**
North America	1,393	1,524	**1,504**
Asia-Pacific	1,821	2,263	**2,223**
Japan	256	364	**332**
Other	35	106	**136**
Total	6,152	7,195	**6,759**

	2003	2004	2005
Property, plant and equipment:			
Germany	2,152	1,962	**1,625**
Other Europe	652	514	**516**
North America	641	619	**1,093**
Asia-Pacific	369	490	**515**
Japan	1	1	**2**
Other	2	1	**–**
Total	3,817	3,587	**3,751**

Revenues from external customers are based on the customers' billing location. Regional employment data is provided in note 7.

Except for sales to Siemens, which are discussed in note 27, no single customer accounted for more than 10% of the Company's sales during any of the years ended September 30, 2003, 2004, and 2005. Sales to Siemens are made primarily by the non-memory product segments.

The Company defines EBIT as earnings (loss) before interest and taxes. The Company's management uses EBIT, among other measures, to establish budgets and operational goals, to manage the Company's business, and to evaluate its performance. The Company reports EBIT information because it believes that it provides investors with meaningful information about the operating performance of the Company and especially about the performance of its separate operating segments.

EBIT is determined as follows from the consolidated statements of operations, without adjustment to the U.S. GAAP amounts presented:

For the years ended September 30	2003	2004	2005
Net (loss) income	(435)	61	**(312)**
Add: Income tax expense	84	154	**120**
Interest expense, net	52	41	**9**
EBIT	(299)	256	**(183)**

(euro in millions, except where otherwise stated)

33 SUBSEQUENT EVENTS

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

ADDITIONAL DISCLOSURES

Additional information to the U.S. GAAP consolidated financial statements pursuant to the transition regulation of the "Bilanzrechtsreformgesetz" in Article 58, paragraph 3 EGHGB

The Company has prepared consolidated financial statements and a group management report for the financial year ended September 30, 2005, in accordance with the German Commercial Code (the "Statutory Report"). The Company has elected to prepare its financial information on the basis of U.S. GAAP in compliance with the requirements of the German Commercial Code. The Statutory Report includes the Consolidated Financial Statements and Notes to the Consolidated Financial Statements, Supplemental Disclosures, and Group Management Report.

Significant differences between German GAAP and U.S. GAAP

Introduction

Infineon Technologies AG, as a German parent company, is subject to the German Commercial Code ("Handelsgesetzbuch", or "HGB"), which principally requires the Company to prepare consolidated financial statements in accordance with the HGB accounting principles and regulations ("German GAAP"). Pursuant to the transition regulation of the "Bilanzrechtsreformgesetz" in Article 58, paragraph 3 EGHGB the Company is exempt from this requirement, if consolidated financial statements are prepared and issued in accordance with a body of internationally accepted accounting principles (such as U.S. GAAP). Accordingly, the Company has prepared its consolidated financial statements in accordance with U.S. GAAP. The following is a description of the significant differences between German GAAP and U.S. GAAP. Additionally, as a U.S. listed entity, the Company must adhere to certain accounting and reporting requirements as prescribed by the U.S. Securities and Exchange Commission.

Fundamental differences

The primary difference between German GAAP and U.S. GAAP is that they are based on different concepts. The emphasis of U.S. GAAP is to provide all relevant information to investors in order to facilitate future investment decisions. German GAAP is oriented towards the protection of creditors, placing emphasis on the prudence concept.

Financial statement presentation

The balance sheet presentation under U.S. GAAP is based on the planned realization of assets and the maturity of liabilities in the normal course of business. The balance sheet presentation under German GAAP is principally defined in HGB section 266, and is based on the enterprise's planned holding time for the respective asset, liability, or equity.

Revenue recognition

Revenue recognition is generally the same under German and U.S. GAAP, whereby revenue is recognized when realized and earned. Differences in the timing of recognition can exist in transactions when the Company retains on-going financial, operational or performance commitments, or the contractual amounts are not objectively verifiable.

Marketable securities

Under German GAAP, marketable debt and equity securities are valued at the lower of acquisition cost or fair market value as of the balance sheet date. Under U.S. GAAP, the Company's marketable securities are classified as available for sale and valued at fair market value as of the balance sheet date. Unrealized gains and losses are reported in other comprehensive income net of deferred taxes.

Inventories

Inventory valuation is based on manufacturing costs under both German and U.S. GAAP. Manufacturing costs under U.S. GAAP are defined as production costs on a full absorption basis, whereby manufacturing overhead is included together with material and other direct manufacturing costs. Under German GAAP certain overhead costs can be excluded from the valuation of inventory.

Goodwill

Under U.S. GAAP, pursuant to SFAS No. 141 in connection with SFAS No. 142, goodwill arising from business combinations accounted for as a purchase after June 30, 2001, is no longer amortized, but rather tested for impairment at the reporting unit level at least annually. Under German GAAP, such goodwill is amortized over four years or its estimated useful life, whichever is shorter.

In-process research and development

Under German GAAP, in-process research and development projects acquired in a business combination are not specifically identified but rather included as part of goodwill. Under U.S. GAAP, acquired in-process research and development is specifically identified, valued, and charged to expense at the date of acquisition.

Derivative financial instruments

Under German GAAP, derivative financial instruments are not recorded on the balance sheet. Unrealized gains are not recognized whereas unrealized losses are accrued for. Under U.S. GAAP derivative financial instruments are recorded on the balance sheet at their fair value. Changes in fair value are recorded in results of operations or other comprehensive income, depending on whether the derivative financial instrument is designated as part of a hedge transaction and on the type of hedge transaction.

Deferred taxes

The main difference in accounting for deferred taxes relates to the fact, that under German GAAP deferred tax assets are not recorded for net operating losses. Under U.S. GAAP, deferred tax assets are recorded for net operating losses and a valuation allowance is established when it is deemed "more likely than not" that the deferred tax asset will not be realized.

Pension and other post-retirement obligations

Under U.S. GAAP, pension obligations are recognized based on the projected benefit obligation using the projected unit credit method. This is also permitted under German GAAP.

Furthermore, different interest rates are used for the evaluation of accrued liabilities.

Under U.S. GAAP, establishing and funding a trust, independent of the Company, results under certain conditions in a corresponding reduction in pension obligations from the balance sheet. Under German GAAP, pension assets and obligations are recorded gross on the balance sheet until such obligations are legally settled.

Stock-based compensation

Under German GAAP, the Company recognizes as expense the difference between the fair market value of the Infineon shares and the exercise price of the stock options, if the fair market value is higher.

Under U.S. GAAP, the Company accounts for stock-based compensation under the intrinsic value method pursuant to APB Opinion 25 which does not result in compensation cost if the fair market value of the stock does not exceed the exercise price of the option on the measurement date. Following the implementation of SFAS 123 (revised 2004), the Company will begin to recognize the cost of granted stock options in the consolidated statements of operations in the first quarter of the 2006 financial year.

Equity offering costs

Under German GAAP, direct costs incurred in connection with equity offerings are expensed, while under U.S. GAAP such costs are recorded as additional paid-in capital.

Accrued liabilities

Under German GAAP, certain costs can be accrued for anticipated future events under certain circumstances. Under U.S. GAAP, recognition of an accrued liability represents an existing obligation to third parties and must meet very specific recognition criteria.

Foreign currency translation

Under German GAAP, foreign currency denominated assets and liabilities are recorded at the spot rate on the transaction date, with only unrealized losses reflected in results of operations at the balance sheet date. Under U.S. GAAP, foreign currency denominated assets and liabilities are translated at the spot rate at the balance sheet date, with both unrealized gains and losses reflected in results of operations. As of September 30, 2004 and 2005, the Company has also denominated current positions at the balance sheet using the spot rate for German GAAP purposes.

Grants subsidies

Under German GAAP, non-taxable investment subsidies and interest subsidies can be recognized in results of operations when received. Under U.S. GAAP, these amounts are deferred and recognized in results of operations during the periods over which the related expense is incurred.

Depreciation on property, plant and equipment

Under U.S. GAAP, depreciation on property, plant and equipment is based on the estimated economic useful life of the asset. Under German GAAP, depreciation on property, plant and equipment is predominantly based on the depreciation rate used for tax purposes.

Equity method accounting

Under German GAAP, consolidated financial statements could include the equity in earnings of associated companies accounted for pursuant to local accounting principles. Under U.S. GAAP, equity in earnings is determined pursuant to U.S. GAAP.

Gain on Associated Company share issuance

Under German GAAP, a capital increase of an associated company which increases the proportional valuation of the Company's investment is reflected in results of operations. Under U.S. GAAP and specific SEC regulations, statement of operations recognition is subject to additional criteria, which, if not met, requires recognition as an adjustment to shareholders' equity.

Minority interest

Under German GAAP, the consideration of minority interest within the first consolidation and the allocation of the investor's share of the results of operations of the investee, is based on the legal ownership percentage. Under U.S. GAAP, the consolidation of minority interest is based on economic interests in the investee and therefore the accounting for minority interest can differ under German GAAP from U.S. GAAP.

Application of exception regulations

Pursuant to HGB section 264a, partnerships, where the unlimited liability is not held by a natural person, or another partnership with a natural person as the unlimited liability partner, are required to prepare financial statements similar to a limited liability corporation. Pursuant to HGB section 264b, such partnerships are exempt from preparing separate financial statements, if they are included in the consolidated financial statements of the holding company and such consolidated financial statements are registered with the trade register of the respective partnership.

Infineon utilizes the exemption in respect of the following companies:

- COMNEON GmbH & Co. OHG, Nuremberg
- Infineon Technologies Dresden GmbH & Co. OHG, Dresden
- Infineon Technologies Flash GmbH & Co. KG, Dresden (previously Ingentix GmbH & Co. KG, Munich)
- Infineon Technologies Immobilien Regensburg GmbH & Co. KG, Regensburg
- Infineon Technologies SC 300 GmbH & Co. KG, Dresden

Pursuant to HGB section 264 par. 3, the Company also utilizes the exception from preparing separate financial statements due to a profit-transfer agreement of the following company:
--- Infineon Technologies Finance GmbH, Munich

Information pursuant to Section 160 Section 1 No. 8 Corporate Act (AktG)

Wachovia Trust Company National Association, Wilmington, DE 19801, USA, informed the Company, by letter dated December 1, 2004, that their share of the voting rights of Infineon Technologies AG fell below the thresholds of 10% and 5% on November 29, 2004. Their new interest in voting rights would amount to 0.00%, equaling 0 shares representing the same number of voting rights.

Siemens AG, Berlin and Munich, Germany, informed the Company, by letter dated November 29, 2004, that their share of the voting rights of Infineon Technologies AG exceeded the thresholds of 5% and 10% on November 29, 2004. Their new interest in voting rights would amount to 18.23%, equaling 136,292,363 shares representing the same number of voting rights.

The Capital Group International Inc., Los Angeles, USA, informed the Company, by letter dated October 2, 2003, that their share of the voting rights of Infineon Technologies AG exceeded the threshold of 5% on September 25, 2003. Their new interest in voting rights would amount to 5.068%, representing 36,534,489 shares. The voting rights would be attributable to the Capital Group International Inc. pursuant to section 22 (1) 1 No. 6 in connection with section 22 (1) 2 and 3 WpHG.

Information pursuant to Section 161 Corporate Act (AktG)

The compliance declaration prescribed by section 161 AktG was submitted on November 23, 2004, and made available to the shareholders on a continuous basis via the Internet.

Accounting fees

During the 2005 financial year, KPMG, our auditors, charged us an aggregate of €3 in connection with professional services rendered for the worldwide audit of our financial statements.

BOARD OF DIRECTORS AND SUPERVISORY BOARD

The remuneration of the Supervisory Board for the year ended September 30, 2005, was €0.6 (consisting of fixed components €0.6, variable components €0 and other consideration of €0). In addition, the members of the Supervisory Board received 1,500 share appreciation rights each. The total remuneration of the Management Board for the year ended September 30, 2005 consisted of fixed salary of €5.2 and other compensation of €0.2. During the year ended September 30, 2005, the Company established a provision for variable bonus of the Management Board of €0.5, which is linked to the realization of the "return on capital employed", which is defined as earnings before interest, taxes, other operating expense (income) and other non-operating expense (income), divided by capital employed. Additionally the Management Board members received 475,000 stock options granted at an exercise price of euro 9.18. The stock options were granted to the Management Board in connection with the Long-Term-Incentive-Plan-2001, which is also the basis for the share appreciation rights. The fair value of each stock option and stock appreciation right at their grant date, if measured under the same conditions as stock options, was euro 4.07.

The individual compensation of our Chairman Dr. Ziebart consisted of fixed components of euro 1,600,000, variable components of euro 100,000 and other compensation of euro 33,052. Furthermore, Dr. Ziebart received 190,000 stock options granted at an exercise price of euro 9.18.

Former members of the Management Board received remuneration in an amount of €4.7 during the 2005 financial year. This amount had been accrued as of September 30, 2004. As of September 30, 2005, accrued pension liabilities for former members of the Management Board amounted to €10.4. A severance agreement with Dr. Schumacher was concluded which provided for the payment of €5.25 to settle all possible claims Dr. Schumacher may have had under his employment contract. Half of this amount was paid in the 2005 financial year. No definitive agreement has been reached with Dr. von Zitzewitz, who left the Management Board of the Company in July 2005, with respect to his possible claims under his employment contract. Although we believe that no further payments (with the possible exception of pension payments) are warranted, any such agreement could involve further payments to Dr. von Zitzewitz.

The following persons were nominated for the Board of Directors and Supervisory Board:

Board of Directors

Name	Age	Membership of the Management Board and other comparable governing bodies during the year ended September 30, 2005
Dr. Wolfgang Ziebart	55	Chairman, President and Chief Executive Officer Additional company positions Comparable positions Member of the Board of Directors of --- Infineon Technologies China Co., Ltd., Shanghai, China
Peter Bauer	45	Executive Vice President Additional external positions Member of the Supervisory Board of --- Siemens VDO Automotive AG, Munich Additional company positions Comparable positions Member of the Supervisory Board of --- Infineon Technologies Austria AG, Villach, Austria Deputy Chairman of the Board of Directors --- Infineon Technologies Japan K.K., Tokyo, Japan Member of the Boards of Directors of --- Infineon Technologies Asia Pacific Pte., Ltd., Singapore --- Infineon Technologies China Co., Ltd., Shanghai, China --- Infineon Technologies North America Corp., Wilmington, Delaware, USA --- Infineon Technologies Savan Ltd., Netanya, Israel
Prof. Dr. Hermann Eul	46	Executive Vice President Additional external positions Member of the Supervisory Board of --- 7Layers AG, Ratingen

Board of Directors

Name	Age	Membership of the Management Board and other comparable governing bodies during the year ended September 30, 2005
Peter J. Fischl	59	Executive Vice President and Chief Financial Officer Additional company positions Comparable positions Chairman of the Supervisory Board of --- Infineon Technologies Austria AG, Villach, Austria Member of the Boards of Directors of --- Infineon Technologies Asia Pacific Pte., Ltd., Singapore --- Infineon Technologies China Co., Ltd., Shanghai, China --- Infineon Technologies North America Corp., Wilmington, Delaware, USA
Kin Wah Loh	50	Executive Vice President Additional external positions Director --- Accton Technologies Corp., Hsinchu, Taiwan (Republic of China) Additional company positions Comparable positions Member of the Boards of Directors of --- Infineon Technologies Asia Pacific Pte., Ltd., Singapore --- Infineon Technologies China Co., Ltd., Shanghai, China --- Infineon Technologies Japan K.K., Tokyo, Japan
Resigned members of the Board of Directors:		
Dr. Andreas von Zitzewitz	45	Executive Vice President until July 16, 2005 Additional external positions Member of the Supervisory Board of --- Steag Hamatech AG, Sternenfels

Supervisory Board

Name	Age	Term expires	Compensation	Membership of the Supervisory Board and other comparable governing bodies during the year ended September 30, 2005
Max Dietrich Kley	65	2010	€58,000.00	Chairman Member of the Supervisory Board of BASF AG Additional external positions Chairman of the Supervisory Board of --- SGL Carbon AG, Wiesbaden Member of the Supervisory Boards of --- Schott AG, Mainz --- HeidelbergCement AG, Heidelberg --- Bayerische Hypo- und Vereinsbank AG, Munich
Klaus Luschtinetz[1]	62	2009	€43,500.00	Deputy Chairman (since January 20, 2004) Chairman of the Infineon central works council Deputy Chairman of the Infineon works council, Munich Balan-/St.-Martin-Straße Comparable external positions Member of the board of administration of Siemens Employees Health Insurance, Munich (until June 2005)
Alfred Eibl[1]	56	2009	€37,458.00	Deputy Chairman (until January 20, 2004) Member of the Infineon works council, Munich Balan-/St.-Martin-Straße
Dr. Joachim Faber	55	2010	€35,041.00	Member of the Management Board of Allianz AG Additional external positions Member of the Supervisory Board --- Bayerische Börse AG, Munich Company positions Chairman of the Supervisory Board of --- Allianz Dresdner Global Investor Deutschland GmbH --- DEGI Deutsche Gesellschaft für Immobilienfonds mbH --- DIT Deutsche Investment Trust Gesellschaft für Wertpapieranlagen mbH Comparable company positions Member of the Supervisory Board of --- AGF Asset Management S.A., Paris, France --- ART Allianz Risk Transfer, Zurich, Switzerland

Supervisory Board

Name	Age	Term expires	Compensation	Membership of the Supervisory Board and other comparable governing bodies during the year ended September 30, 2005
Johannes Feldmayer	49	2010	€19,333.00	Member of the Central Management Board of --- Siemens AG Company positions Comparable positions Member of the board of administration of --- Siemens A.E., Athens, Greece Chairman of the Supervisory Board of --- Siemens Rt., Budapest, Hungary Chairman of shareholders' representatives of --- Siemens sro, Prague, Czech Republic Deputy Chairman of the boards of administration of --- Siemens S.A. Madrid, Spain --- Siemens S.p.A. Milan, Italy --- Siemens Schweiz AG, Zurich, Switzerland Member of the boards of administration of --- Siemens France S.A., Saint-Denis, France --- Siemens A.S., Istanbul, Turkey --- Siemens A.S., Copenhagen, Denmark Member of the Supervisory Boards of --- Siemens Holdings plc, Bracknell, Great Britain --- Siemens AB, Stockholm, Sweden --- Siemens AG, Vienna, Austria Comparable external positions Member of the Supervisory Board of --- Exxon Mobil Central Europe Holding GmbH, Hamburg
Jakob Hauser[1]	53	2009	€37,458.00	Member of the Infineon central works council Chairman of the Infineon works council, Munich-Perlach

Supervisory Board

Name	Age	Term expires	Compensation	Membership of the Supervisory Board and other comparable governing bodies during the year ended September 30, 2005
Dr. Stefan Jentzsch	44	2010	€29,000.00	Member of the Management Board of --- Bayerische Hypo- und Vereinsbank AG (until November 18, 2005) Additional external positions Member of the Supervisory Boards of --- Deutsche Börse AG, Frankfurt --- Premiere AG, Munich (since March 9, 2005) --- DAB Bank AG, Munich (until March 8, 2005) Company positions Member of the Supervisory Board of --- HVB Systems AG, Munich Chairman of the board of administration of --- HVB Wealth Management Holding GmbH, Munich Deputy chairman of the Supervisory Boards of --- Vereins- und Westbank AG, Hamburg --- HVB Info AG, Munich (until May 31, 2005) Comparable positions Member of the Supervisory Board of --- Bank Austria Creditanstalt AG, Vienna, Austria Chairman of the Supervisory Boards of --- HVB Alternative Financial Products AG, Vienna, Austria --- HVB Alternative Investment AG, Vienna, Austria
Prof. Dr. Renate Köcher	53	2010	€19,333.00	Director --- Institut für Demoskopie Allensbach Member of the Supervisory Boards of --- Allianz AG, Munich --- BASF AG, Ludwigshafen --- MAN AG, Munich
Michael Ruth[1]	45	2009	€29,000.00	Infineon Technologies AG, Senior Vice President Strategy Planning and Controlling – Advanced Logic Representative of senior management Additional company positions Comparable positions Member of the board of administration of --- ALTIS Semiconductor S.N.C., Essonnes, France
Dieter Scheitor[1]	54	2009	€29,000.00	Team leader of the electrical industry unit of the Management Board of IG Metall, Frankfurt
Gerd Schmidt[1]	51	2009	€29,000.00	Deputy Chairman of the Infineon central works council Chairman of the Infineon works council, Regensburg West
Prof. Dr. rer. nat. Doris Schmitt-Landsiedel	52	2010	€22,958.00	Professor at the Munich Technical University

Supervisory Board

Name	Age	Term expires	Compensation	Membership of the Supervisory Board and other comparable governing bodies during the year ended September 30, 2005
Kerstin Schulzendorf[1]	43	2009	€29,000.00	Deputy Chairman of the Infineon works council, Dresden
Alexander Trüby[1]	35	2009	€37,458.00	Member of the Infineon works council, Dresden
Prof. Dr. rer. nat. Martin Winterkorn	58	2010	€39,875.00	Chairman of the Management Board of --- Audi AG Member of the Management Board of --- Volkswagen AG Additional external positions Member of the Supervisory Boards of --- Salzgitter AG, Salzgitter --- FC Bayern München AG, Munich --- TÜV Süddeutschland Holding AG, Munich Additional company positions Comparable positions Member of the boards of administration of --- SEAT S.A., Barcelona, Spain --- Automobili Lamborghini Holding SpA, Sant' Agata Bolognese, Bologna, Italy
Prof. Dr.-Ing. Dr.-Ing. E.h. Klaus Wucherer	61	2010	€37,458.00	Member of the Management Board of --- Siemens AG Additional external positions Member of the Supervisory Board of --- Deutsche Messe AG, Hanover Company positions Member of the Supervisory Board of --- BSH Bosch and Siemens Hausgeräte GmbH, Munich Comparable company positions Chairman of the boards of administration of --- Siemens Ltd., Beijing, China --- Siemens K.K., Tokyo, Japan --- Siemens S.A., Lisbon, Portugal --- Siemens Ltd., Mumbai, India
Resigned members of the Board of Directors:				
Resigned January 25, 2005:				
Günther Fritsch			€9,666.00	
Dr. h.c. Martin Kohlhaussen			€14,500.00	
Univ.-Prof. Dr.-Ing. Ingolf Ruge			€14,500.00	

1 Employee representative.

The Supervisory Board maintains the following committees

Mediation Committee

Max Dietrich Kley (since September 1, 2004)
Klaus Luschtinetz (since January 20, 2004)
Alexander Trüby (since January 20, 2004)
Prof. Dr.-Ing. Dr.-Ing. E.h. Klaus Wucherer (until April 29, 2005)

Executive Committee

Max Dietrich Kley (since September 1, 2004)
Klaus Luschtinetz (since January 20, 2004)
Prof. Dr. Martin Winterkorn (since August 1, 2005)
Dr. Martin Kohlhaussen (until January 25, 2005)

Investment, Finance and Audit Committee

Max Dietrich Kley (since September 1, 2004)
Dr. Joachim Faber (since April 29, 2005)
Klaus Luschtinetz (since January 20, 2004)
Prof. Dr.-Ing. Dr.-Ing. E.h. Klaus Wucherer (from October 1, 2004 until January 25, 2005)

Strategy and Technology Committee (in existence until April 30, 2005)

Alfred Eibl
Jakob Hauser
Alexander Trüby
Prof. Dr. rer. nat. Schmitt-Landsiedel (since January 25, 2005)
Prof. Dr. rer. nat. Martin Winterkorn
Univ.-Prof. Dr.-Ing. Ingolf Ruge (from October 1, 2004 until January 31, 2005)
Prof. Dr.-Ing. Dr.-Ing. E.h. Klaus Wucherer (from October 1, 2004 until April 20, 2005)

Significant Subsidiaries and Associated Companies

Name and location of company	Share in capital
EUPEC Europäische Gesellschaft für Leistungshalbleiter mbH, Warstein-Belecke, Germany	100 %
Infineon Technologies Dresden GmbH & Co. OHG, Dresden, Germany	100 %
Infineon Technologies SC300 GmbH & Co. OHG, Dresden, Germany	100 %
Infineon Technologies Finance GmbH, Munich, Germany	100 %
Infineon Technologies Flash GmbH &Co. KG, Dresden, Germany	100 %
Infineon Technologies Austria AG, Villach, Austria	100 %
Infineon Technologies-Fabrico de Semicondutores, Portugal S.A., Vila do Conde, Portugal	100 %
Infineon Technologies France S.A.S., Saint Denis, France	100 %
Infineon Technologies Holding B.V., Rotterdam, The Netherlands	100 %
SensoNor AS, Horten, Norway	100 %
Infineon Technologies Holding North America Inc., Wilmington, Delaware, USA	100 %
Infineon Technologies Richmond LP, Wilmington, Delaware, USA	100 %
Infineon Technologies Asia Pacific Pte. Ltd., Singapore	100 %
Infineon Technologies China Co. Ltd., Shanghai, China	100 %
Infineon Technologies (Advanced Logic) Sdn. Bhd., Malacca, Malaysia	100 %
Infineon Technologies (Integrated Circuit) Sdn. Bhd., Malacca, Malaysia	100 %
Infineon Technologies (Malaysia) Sdn. Bhd., Malacca, Malaysia	100 %
Infineon Technologies Japan K.K., Tokyo, Japan	100 %
Infineon Technologies Suzhou Co., Ltd., Suzhou, China	73 %
ALTIS Semiconductor S.N.C., Essonnes, France	50 %
Inotera Memories Inc., Taoyuan, Taiwan	44 %

Consolidated financial data 2001–2005

Consolidated financial data Infineon Technologies AG € in millions[1]

As of and for the financial year ended September 30	2001	2002	2003	2004	2005
Summary consolidated statements of operations data					
Net sales	5,347	4,890	6,152	7,195	**6,759**
By region:					
Germany	1,636	1,266	1,535	1,675	**1,354**
Other Europe	1,172	943	1,112	1,263	**1,210**
North America	1,208	1,158	1,393	1,524	**1,504**
Asia-Pacific	1,056	1,287	1,821	2,263	**2,223**
Japan	191	159	256	364	**332**
Others	84	77	35	106	**136**
By segment[2]:					
Automotive, Industrial and Multimarket	2,206	1,945	2,186	2,540	**2,516**
Communication	1,451	1,019	1,428	1,689	**1,391**
Memory Products	1,614	1,861	2,485	2,926	**2,826**
Other Operating Segments	20	18	21	11	**12**
Corporate and Reconciliation	56	47	32	29	**14**
Cost of goods sold	4,580	4,289	4,614	4,670	**4,909**
Gross profit	767	601	1,538	2,525	**1,850**
Research and development expenses	1,189	1,060	1,089	1,219	**1,293**
Selling, general and administrative expenses	782	643	679	718	**655**
Restructuring charge	117	16	29	17	**78**
Other operating income (expense), net	(200)	(46)	85	257	**92**
Operating income (loss)	(1,121)	(1,072)	(344)	314	**(268)**
Interest expense, net, inclusive of subsidies	(1)	(25)	(52)	(41)	**(9)**
Equity in earnings (losses) of associated companies	21	(47)	18	(14)	**57**
Gain (loss) on associated companies share issuance	11	18	(2)	2	**–**
Other non-operating income (expense), net	65	(41)	21	(64)	**26**
Minority interests	6	7	8	18	**2**
Income (loss) before income taxes	(1,019)	(1,160)	(351)	215	**(192)**
Income tax benefit (expense)	427	143	(84)	(154)	**(120)**
Net income (loss) from continuing operations	(592)	(1,017)	(435)	61	**(312)**
Income (loss) from discontinued operations	1	(4)	–	–	**–**
Net income (loss)	(591)	(1,021)	(435)	61	**(312)**
Basic and diluted earnings (loss) per share (in euro)	(0.92)	(1.47)	(0.60)	0.08	**(0.42)**
EBIT	(1,018)	(1,135)	(299)	256	**(183)**
By segment[2]:					
Automotive, Industrial and Multimarket	466	169	148	252	**134**
Communication	(340)	(353)	(213)	(44)	**(295)**
Memory Products	(938)	(630)	31	169	**122**
Other Operating Segments	(26)	(57)	(50)	(75)	**(4)**
Corporate and Reconciliation	(180)	(264)	(215)	(46)	**(140)**

1 Columns may not add due to rounding.
2 Effective January 1, 2005, we reorganized certain of our segments to better reflect our customer and market profiles. Accordingly, the segment results for prior years have been reclassified to be consistent with the reporting structure and presentation of the 2005 financial year, and to facilitate analysis of current and future operating segment information.

Continuation consolidated financial data Infineon Technologies AG € in millions[1]

As of and for the financial year ended September 30	2001	2002	2003	2004	2005
Summary consolidated balance sheets data					
Cash and cash equivalents	757	1,199	969	608	**1,148**
Marketable securities	93	738	1,784	1,938	**858**
Trade accounts receivable, net	626	758	876	1,056	**952**
Inventories	882	891	959	960	**1,022**
Deferred income taxes	39	82	113	140	**125**
Other current assets	479	523	675	590	**469**
Total current assets	2,876	4,191	5,376	5,292	**4,574**
Property, plant and equipment, net	5,233	4,491	3,817	3,587	**3,751**
Long-term investments, net	655	708	425	708	**779**
Restricted cash	86	70	67	109	**88**
Total assets	9,743	10,918	10,875	10,864	**10,284**
Short-term debt, including current portion of long-term debt	119	120	149	571	**99**
Long-term debt, excluding current portion	249	1,710	2,343	1,427	**1,566**
Shareholders' equity	6,900	6,158	5,666	5,978	**5,629**
Summary consolidated statements of cash flows data					
Net cash provided by operating activities	221	226	731	1,857	**1,039**
Net cash used in investing activities	(1,813)	(1,244)	(1,522)	(1,809)	**(238)**
Depreciation and amortization	1,121	1,370	1,437	1,320	**1,316**
Purchases of property, plant and equipment	(2,282)	(643)	(872)	(1,163)	**(1,368)**
The Infineon share (as of September 30)					
Dividend per share in €	–	–	–	–	**–**
Closing price Xetra Trading System in €	13.50	5.61	11.22	8.22	**8.18**
Closing price New York Stock Exchange (NYSE) in U.S. dollar	12.39	5.70	12.89	10.22	**9.92**
Shares outstanding in millions	692.4	720.8	720.9	747.6	**747.6**
Market capitalization	9,347	4,044	8,088	6,145	**6,115**
Market capitalization U.S. $ in millions	8,579	4,109	9,292	7,640	**7,416**
Key figures					
Equity-assets ratio	71%	56%	52%	55%	**55%**
Debt-equity ratio	5%	30%	44%	33%	**30%**
Net cash position[2]	482	107	261	548	**341**
Employees year end in total figures	33,813	30,423	32,308	35,570	**36,440**
By region:					
Germany	16,814	15,716	16,166	16,387	**16,119**
Other Europe	5,007	4,590	5,034	5,631	**5,482**
North America	3,023	2,889	2,757	2,982	**3,193**
Asia-Pacific	8,822	7,093	8,116	10,340	**11,451**
Japan	127	107	118	133	**158**
Others	20	28	117	97	**37**
By function:					
Production	23,416	20,822	22,405	24,540	**25,114**
Research & development	5,510	5,374	5,935	7,160	**7,401**
Sales & marketing	2,259	2,010	2,048	1,948	**2,016**
Administrative	2,628	2,217	1,920	1,922	**1,909**

1 Columns may not add due to rounding.
2 Cash and cash equivalents plus marketable securities minus short and long-term debt.

Financial and technology glossary

Financial glossary

ADS: American Depositary Shares – ADS are U.S.-traded stock certificates for non-U.S. stocks. These certificates simplify access to U.S. capital markets for non-U.S.-based companies, and in turn provide U.S. investors with investment opportunities in non-U.S.-based companies. Infineon's ADS are listed on the New York Stock Exchange (NYSE) at a 1:1 ratio.

Cash flow: The cash-effective balance arising from inflows and outflows of funds over the financial year. The cash flow statement is part of the consolidated financial statements and shows how the Company generated cash during the period and where it spent cash, in terms of operating activities (cash the Company made by purchasing/selling goods and services), investing activities (cash the Company spent for investment, or cash it raised from divestitures), and financing activities (cash the Company raised by selling stocks, bonds and loans or spent for the redemption of stocks or bonds).

Dax: Deutscher Aktienindex – The German Blue Chip Index tracking the 30 major German companies traded on the Frankfurt Stock Exchange, in terms of order volume or market capitalization.

Debt-equity ratio: An indicator of the Company's financing structure, representing the total short and long-term debt as a percentage of shareholders' equity.

Deferred taxes: Since tax laws often differ from the recognition and measurement requirements of financial accounting standards, differences can arise between (a) the amount of taxable income and pre-tax financial income for a year and (b) the tax bases of assets or liabilities and their reported amounts in financial statements. A deferred tax liability and corresponding expense results from income that has already been earned for accounting purposes but not for tax purposes. Conversely, a deferred tax asset and corresponding benefit results from amounts deductible in future years for tax purposes but that have already been recognized for accounting purposes.

EBIT: Infineon defines EBIT as "Earnings Before Interest and Taxes". This is the measure that Infineon uses to evaluate the operating performance of its segments.

EBIT margin: An indicator of operating performance, calculated as the percentage of EBIT in relation to net sales.

Equity-to-assets ratio: An indicator of the proportion of equity capital in the Company's financial structure, calculated as the ratio of shareholders' equity capital to total assets.

EPS: Earnings (loss) Per Share – basic earnings (loss) per share ("EPS") is calculated by dividing net income (loss) by the weighted average number of ordinary shares outstanding during the reporting period (financial quarter or year). Diluted EPS is calculated by dividing net income by the sum of the weighted average number of ordinary shares outstanding plus all additional ordinary shares that would have been outstanding if potentially dilutive securities or ordinary share equivalents had been issued.

Free cash flow: Inflow and outflow of cash from operating and investing activities excluding purchases or sales of marketable securities.

Goodwill: An intangible asset of the Company that results from a business acquisition, representing the excess of the acquired entity's purchase price (cost) over the fair value of the net assets acquired and liabilities assumed. Under U.S. GAAP, goodwill is not reduced through regularly scheduled amortization, but rather written down to its fair value if impaired. An impairment assessment is done at least once a year.

Gross cash position: Total of cash and cash equivalents and marketable securities.

Gross profit or margin: Net sales less cost of goods sold.

In-process research and development: Under German GAAP, in-process research and development projects acquired in a business combination are not specifically identified but rather included as part of goodwill. Under U.S. GAAP, acquired in-process research and development is specifically identified, valued, and charged to expense at the time of acquisition.

Minority interest: Proportional share in net income not ascribed to the consolidated group but to outside shareholders that hold a minority share in the equity of the Company's subsidiaries.

Net cash position: Gross cash position less long and short-term debt.

Registered shares: Shares registered in the name of a certain person. This person's details and number of shares are registered in the Company's share ledger in accordance with securities regulations. Only individuals registered in the Company's stock ledger are considered shareholders of the Company and are, for example, able to exercise their rights at the annual general meeting of shareholders.

ROE: Return On Equity – An indicator of the Company's financial performance, representing net income/loss as a percentage of the average amount of shareholders' equity capital employed during the period.

ROTA: Return On Total Assets – An indicator of the Company's financial success, representing net income/loss as a percentage of the average total assets employed during the period.

U.S. GAAP: Accounting principles generally accepted in the United States of America. Infineon prepares its consolidated financial statements according to U.S. GAAP.

Technology glossary

2G: Second generation, digital mobile telephony. Subsequent to the first generation (analog), 2G digital signals offer good overall sound quality and numerous data services. Second generation mobile communications standard in Europe: GSM.

2.5G: Currently most common used mobile communications infrastructure. 2.5-generation mobile communications standard in Europe: GPRS.

3G: Third generation of mobile communications: Provides the broadband transmission of voice and data with considerably higher capacity compared to the second generation. Third generation mobile communications standard in Europe: UMTS.

300-millimeter technology: Comprehensive term for the manufacture and processing of wafers with a diameter of 300 millimeters. At Infineon, the term is used as a synonym for the manufacture of memory chips on a 300-millimeter wafer.

300-millimeter production site: A semiconductor production site which can process wafers with a diameter of 300 millimeters.

Advanced Memory Buffer: The Advanced Memory Buffer (AMB) is a chip on a FB-DIMM memory module which buffers data and coordinates the communication between the memory module and the memory controller.

ADSL2, ADSL2+: ADSL2 and ADSL2+ are further developments of the ADSL (Asymmetric Digital Subscriber Line) standard which above all improve the data rates and range of ADSL connections. The increased range allows network providers to offer ADSL to a higher number of potential customers, while the increased data rates allow for new services like high-definition television (HDTV) over the Internet. ADSL2+ increases the maximum data rate to 25 megabit per second downstream compared to the 16 megabits per second with ADSL2. These data rates easily allow for the transmission of multiple TV or single HDTV channels.

ASIC: Application-Specific Integrated Circuit. Logic IC constructed for a specific application and a specific customer, and implemented on an integrated circuit.

ASSP: Application-Specific Standard Product. Standard product constructed for a specific use that can be used by several customers, and implemented on an integrated circuit.

Back-end manufacturing: The part of the semiconductor manufacturing process that happens after the wafer has left the cleanroom (front-end manufacturing). This includes testing the chips at wafer level, repairing the chips if necessary, dicing the wafers and packaging the individual chips. There is a growing trend among semiconductor manufacturers to outsource the assembly, and sometimes even the testing, to independent assembly companies. Much of the assembly capacity is based in the Pacific Rim countries.

Baseband IC: A baseband IC processes the digital signals received and those to be sent. This complex component usually comprises a digital signal processor, microcontroller, memory and analog circuits. It essentially forms the core of a wireless communications system.

BiCMOS: Bipolar Complementary Metal Oxide Substrate. IC-technology which combines bipolar transistors and CMOS field effect transistors on one chip.

Bit: Information unit; can take one of two values: "true" / "false" or "0" / "1".

Bluetooth: Technology for wireless voice and data transmission over short distances.

Broadband applications: Any network technology to provide high-bandwidth data transmission with bandwidths of several hundreds of kilobits per second or more.

Byte: Unit of information in data processing components. One byte is equivalent to 8 bits.

CDMA: Code Division Multiple Access. Process used in mobile communications systems, allowing several users simultaneous access to a transmission channel. Advantage: optimal utilization of available transmission bandwidth.

Chip card: Plastic card with built-in memory chip or microprocessor, which can be combined with a Personal Identification Number (PIN).

CMOS: Complementary Metal Oxide Substrate. Standard semiconductor manufacture technology used to produce microchips with low power usage and a high level of integration.

Customer premises equipment: The subscriber line, also called exchange line or last mile, is the part of the telephone network that connects the telephone exchange of the service provider with the telephone connection inside the user's/subscriber's house.

DDR: Double Data Rate. A technique increasing the data transmission rates of semiconductor RAMs by reading and writing data on both the rising and falling edges of the clock signal which leads to a doubled data transmission rate compared to the use of only one data transmission rate.

DDR2: A further development of the DDR technology. This is currently the commonly used memory technology for PCs and notebooks.

DDR3: A further development of the DDR2 technology. Expected in PCs in the second half of the calendar year 2007.

DECT: Digital Enhanced Cordless Telecommunications. Uniform European standard for digital wireless communications systems.

DRAM: Dynamic Random Access Memory. Widely used low-cost memory chip technology based on high-level integration. Examples of DRAM chips: SDRAM, DDR DRAM, RDRAM, SGRAM. (See "RAM").

DSL: Digital Subscriber Line. A broadband digital connection using telephone networks.

Dual die technology: Assembly technology for memory ICs. In the Dual-die-Technology two identical chips in a BGA (Ball Grid Array) casing are stacked on-top of each other. This doubles the capacity of the components and therefore also the memory modules without requiring additional board space.

DVB-T: Digital Video Broadcasting – Terrestrial. Describes the terrestrial (earthbound) variant of DVB which is used in European states and other countries as a standard for the transmission of digital television and radio via aerials.

EDGE: Enhanced Data Rates for GSM Evolution. Describes a technology for an increased data rate in GSM mobile communications networks which, to date, is only very rarely applied. Like GPRS, EDGE is evolved as a further development of the GSM technology which can be introduced in mobile communications networks at modest efforts.

FB-DIMM: Fully Buffered Dual-Inline Memory Module. Represents a novel memory module technology which, in the area of servers, ensures that the maximum memory system capacity can be increased in the light of higher memory clock rates where it usually would needed to be decreased.

FCOS: Flip Chip on Substrate. Stands for the newest development in chip card technology. This process combines the new flip chip assembly with a revolutionary concept of material usage. FCOS chip modules provide increased mechanical stability and optical quality for memory and microprocessor cards.

Flash memory: A type of non-volatile memory. Its contents are preserved, even when the system's power is turned off.

Front-end manufacturing: Wafer processing that takes place in the cleanroom, as opposed to processing that happens after the wafer has been essentially finished. Once the wafer is done with its cleanroom processing, it moves into the back-end manufacturing, which involves testing and assembly (packaging). See also: back-end manufacturing.

Giga: In information technology, prefix denoting a multiple of 2^{30} as in Gigabit (Gbit), Gigabyte (GByte).

GPRS: General Packet Radio Service. New generation of mobile communications (2.5 group) for higher data transmission rates (up to 115 kbits/s) in GSM networks.

GPS: Global Positioning System. Satellite and radio-based location identification and positioning process based on the transit-time differences of received signals.

Graphics RAMs: Also called SGRAM (Synchronous Graphics RAM). A special, advanced variant of the SDRAM components optimized for graphical applications and used for high-end graphics cards. By using an internal command pipeline, access sequences can be buffered on the chip, whichlead to increased access bandwidths.

GSM: Global System for mobile communications. Currently the most widely used digital mobile communications standard in the world.

HDTV: High Definition Television is a generic term for a number of television standards which are characterized by an increased vertical, horizontal and/or temporal resolution compared to conventional television. This is accompanied by the transition from the 4:3 to the 16:9 aspect ratio.

Home gateway: This allows high-speed data transmissions from and to private homes. They can be considered as the next evolutionary step following the set-top box (decoder).

IPTV: Internet Protocol Television. Describes the digital transmission of TV programs and movies over a digital data network. The Internet Protocol (IP) on which the Internet is based, is used. The transmission of digital video signals demands a high data rate (about six to eight megabits for HDTV). Therefore IPTV was not possible before the wide spread of broadband Internet connections to the customer (e.g. ADSL2, cable modem or VDSL) and introduction of new compression methods.

IC: Integrated Circuit. Electronic component parts composed of semiconductor materials, such as silicon; numerous components, such as transistors, resistors, capacitors and diodes can be integrated into ICs and interconnected.

ISDN: Integrated Services Digital Network. Type of on-line connection, integrating telecommunications services, such as telephone, fax or data transmissions into one single network.

Kilo: In information technology, prefix denoting a multiple of 2^{10} as in kilobit (Kbit), kilobyte (Kbyte).

LAN: Local Area Network. Data communications network in an extremely limited physical space, such as the confines of one building.

Logic segment: Combination of the two Infineon segments Automotive, Industrial and Multimarket and Communication.

Mega: In information technology, prefix denoting a multiple of 2^{20} as in Megabit (Mbit), Megabyte (Mbyte).

Megahertz: Hertz (Hz) is the unit for frequency. It is named after the German physicist Heinrich Rudolf Hertz. The Hertz determines the number of oscillations per second, or more generally the number of repetitive processes per second. Frequently used units are kilohertz (thousand oscillations per second), megahertz (one million oscillations per second) and gigahertz (one billion oscillations per second).

Memory stick: A memory stick is a digital storage media for data. It is a proprietary standard developed by Sony and was introduced in 1998. Memory sticks are used in a range of products from Sony in the field of consumer electronics.

Microcontroller: A microprocessor integrated into a single IC combined with memory and interfaces, functioning as an embedded system. Logical integrated circuits of the highest complexity can be designed in a microcontroller and controlled by software.

Micro-DIMM: Micro-Dual-Inline Memory Module. A form of memory module which, in comparison with the SO-DIMM, has been more miniaturized. This miniature memory module is designed for use as main memory in sub-notebooks.

Micron (micrometer): Metric linear measure, corresponding to the millionth part of a meter (10^{-6}). Symbol: µm. As an example, the diameter of a single human hair is 0.1 millimeter or 100 µm.

MicroSlim: A novel storage concept for the non-volatile memory on Infineon chip cards. It uses only one transistor instead of two per memory cell.

Mobile-RAM: Low-power DRAM designed for mobile applications like PDAs and smart phones.

MP3 player: A battery-powered device which plays digital audio data stored in MP3 format.

MultiMediaCard: A format for a digital storage medium. The MultiMediaCard standard was developed by Infineon and SanDisk in 1997. A MultiMediaCard uses NAND flash technology to store data.

NAND flash: NAND flash memory is mostly used for large storage media like USB sticks and flash memory cards (MultiMediaCard, SD Card, memory stick, etc.). These memory cards are for example used in MP3 players and digital cameras.

Non-volatile memory: Memory that does not lose its stored information even when the power supply is turned off.

PDA: Personal Digital Assistant. An electronic address book, appointment calendar, and notebook; is usually synchronized with the PC.

Power semiconductor: Over the last 30 years power semiconductors mostly replaced electromechanical solutions in the areas of drive technolgoy and power management and supply due to their ability to form high energy flows almost at will. The advantage of the components is the possibility to switch extremely fast (typically a fraction of a second) between the "open" and the "closed" state. With the rapid sequences of on/off pulses almost any form of energy flow can be created, for example a sinus-wave.

Radio frequency (RF) transceiver: The term "transceiver", created from the words "transmitter" and "receiver", is used to describe a combination of transmitter and receiver in a single component used in wireline and wireless communications. Radio frequency transceivers are used in wireless communications, for example, in mobile phones and cordless telephones.

RAM: Random Access Memory. Semiconductor memory that can be accessed in any order. The name is derived from, and is in contrast to, the sequential access memory of a tape storage medium. Data memory, known as main memory, contains programs and data. Examples: SRAM and SDRAM. (See "DRAM").

ROM: Read-Only Memory. Digital, non-volatile data memory in which data can be permanently stored regardless of the power supply. The most recent developments are in the form of flash memories (NAND and NOR).

SD card: Secure Digital Memory Card. A digital storage medium. The term "secure digital" comes from the additional hardware functions for the Digital Rights Management (DRM). With a memory area protected from user access the card prevents the illegal playing of protected media files.

Semiconductor: Crystalline material; its electrical conductivity can be changed as desired by the application of doping materials (most often boron or phosphorous). Semiconductors include silicon or germanium. The term is also applied to ICs made of these materials.

Server: General term used to describe powerful computer within computer networks which fulfill various tasks. Examples are print servers, web servers, mail servers, database servers etc.

Silicon: A chemical element with semiconducting characteristics. Silicon is the most important raw material in the semiconductor industry.

Smart card: A plastic card, usually about the size of a credit card, with an embedded microcontroller. In contrast to a memory-based card, the microprocessor permits the extremely secure processing of large volumes of data.

Smart phone: A smart phone combines the performance of a PDA with a mobile phone. Depending on the manufacturer the device will be more PDA or more mobile phone. This means that smart phones can log on to a mobile phone network or, as small computers, also run applications like a PDA.

SMS: Short Message Service. A telecommunications service for the transmission of text messages. It was initially developed for GSM mobile communications and is now also available via landline connections.

Tire Pressure Monitoring System (TPMS): A system that monitors the pressure inside a tire and alerts the driver when the pressure is insufficient.

Triple-play: Describes the communications package of the future consisting of high-speed Internet connection, telephone service (Voice over IP) and online video services. Triple-play can be provided using copper wires (DSL connection), cable connections or radio connections.

Trusted Platform Module: The Trusted Platform Module (TPM) is chip which has the task of making the computer more secure. It is equivalent to a permanently embedded smart card with the difference of being associated with a system, not a particular user. In addition to its use in PCs it will be integrated into PDAs, mobile phones and consumer electronics. The chip is passive and can not directly influence the boot process or the operation of the device. It contains a unique identifier and allows for the identification of the computer.

UMTS: Universal Mobile Telecommunications System. Designed to be the future global digital standard for mobile communications. UMTS enables data transmission of up to 2 Mbit/s.

USB stick: A USB device with a very small stick or plug like design. The term is colloquial and does not stand for a class of products. In German it usually describes an USB storage device serving as exchangeable storage.

VDSL, VDSL2: Very High Data Rate Digital Subscriber Line. VDSL, like ADSL, is a digital transmission technology for the connection of customers using copper wires. It offers significantly higher data rates of up to 52 megabits per second. This decreases the maximum range of the bridgeable copper wire to a maximum of 1.5 kilometer. Therefore the use of VDSL2 is restricted to hybrid networks as an extension to an already existing fiber-optics connection. The successor VDSL2 will offer bandwidths of up to 100 megabits per second. The targeted range for this speed is about 200 meter.

Voice over IP (VoIP): IP telephony is the ability to telephone via a computer network based on the Internet Protocol. When IP telephony is used to conduct conversations over the Internet, one talks of Internet telephony. The essential difference to conventional telephony is that voice data is not transmitted via a switched connection through a telephone network, but rather it is split up into IP packages which travel through the network to their destination along an unspecified route. IP telephony can share the infrastructure, i.e. the network, with other communications services.

Volatile memory: Memory that loses stored information when the system's power is turned off.

Wafer: Disc made of a semiconductor material, such as silicon, with a diameter of up to 300 millimeters.

WDCT: Worldwide Digital Cordless Technology. Unified standard for wireless digital communications systems in North America. An adaptation of the DECT standard.

WLAN: Wireless Local Area Network. A local computer network which connects computers with each other or the Internet via a radio connection.

Workstation: very capable PC.

xDSL: xDigital Subscriber Line. Generic term for various technical concepts for broadband, digital data transmission via existing twisted copper wires. Depending on the configuration, the "x" stands for: Asymmetric (A), High bit-rate (H), Single line (S), Symmetric High bit-rate (SH) or Very high bit-rate (V).

Financial calendar
Important financial dates 2006*

... Tuesday, January 24
Publication of first quarter 2006 results

... Thursday, February 16, 10:00 a.m. CET
2006 Shareholders' Annual General Meeting in Munich, ICM (Internationales Congress Center München)

... Wednesday, April 26
Publication of second quarter 2006 results

*preliminary

Annual Report 2005

Published by	Infineon Technologies AG, Munich, Germany
Editors	Investor Relations, Corporate Communications, Accounting & Financial Reporting
Copy deadline	November 30, 2005
Financial year	October 1 to September 30
Independent Auditors	KPMG Deutsche Treuhand-Gesellschaft AG, Wirtschaftsprüfungsgesellschaft Berlin und Frankfurt am Main, Germany
Designed by	häfelinger + wagner design, Munich, Germany
Photography	Andreas Pohlmann
Printed by	Kunst- und Werbedruck GmbH & Co. KG, Bad Oeynhausen, Germany

Printed in Germany.

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

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