

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company generated net income of \$25.6 million (or \$1.91 basic earnings per share and \$1.65 diluted earnings per share) in 2004, as compared to \$10.1 million (or \$0.79 basic earnings per share and \$0.70 diluted earnings per share) for 2003. This 153% increase is due primarily to the 35.6% sales increase at gross profit margins of 32.7% compared to gross profit margins of 26.7% in 2003.

### *Year 2003 Compared to Year 2002*

Net sales for 2003 increased \$21.1 million to \$136.9 million from \$115.8 million for 2002. The 18.2% increase was due primarily to a 19.5% increase in units sold as a result of increased demand for the Company's products, as well as a more favorable pricing environment compared to 2002. In 2003, ASPs for discrete products increased 4% while ASPs for wafers fell 7%; consequently, overall ASPs decreased 1%.

Gross profit for 2003 increased 36.8% to \$36.5 million from \$26.7 million for 2002. Of the \$9.8 million increase, \$5.0 million was due to the increase in gross profit margin from 23.1% in 2002 to 26.7% in 2003, while \$4.8 million was due to the 18.2% increase in net sales. Gross profit increases in Asia were the primary contributor to the gross profit increase in 2003. Gross profit margin in the fourth quarter of 2003 increased to 29.5% due to increased capacity utilization, continuing manufacturing efficiencies, relatively stable pricing, and a product mix that continues to shift towards higher-value performance discretes and arrays.

For 2003, SG&A increased \$3.4 million to \$19.6 million from \$16.2 million for 2002. The 20.7% increase in SG&A was due primarily to higher sales commissions associated with the 18.2% increase in sales, and higher labor benefits expenses. Also contributing to the increased SG&A were higher corporate and administrative expenses, including legal and accounting fees associated with Sarbanes-Oxley compliance. SG&A, as a percentage of sales, increased to 14.3% for 2003 from 14.0% in 2002.

R&D expenses increased to \$2.0 million, or 1.5% of sales, in 2003 from \$1.5 million, or 1.3% of sales, in 2002. R&D expenses are primarily related to new product development at the silicon wafer level, and, to a lesser extent, at the packaging level.

In 2003, operating profit margins were negatively affected by a \$1.0 million reserve for fixed asset impairment, primarily as a result of the re-engineering of our wafer production lines. During the year, we took advantage of opportunities to purchase more efficient equipment at discounts. As a result, we retired un-depreciated equipment that was replaced.

Net interest expense for 2003 decreased \$323,000 to \$860,000 from \$1.2 million in 2002, due primarily to a decrease in the use of the Company's credit facilities, as well as lower interest rates. In 2003, the Company paid down \$5.8 million on its long-term debt, reducing the balance, net of current portion from \$12.6 million to \$6.8 million.

Other expense for 2003 increased \$72,000 compared to last year, primarily due to the discontinuance of income Diodes-FabTech was receiving from an external company's use of its testing facilities in 2002, a decrease in high-technology grant income received at Diodes-China in 2003, and currency exchange losses primarily in Asia in 2003, partly offset by a severance payment in accordance with the terms of a separation agreement in 2002, as well as the reduction in the expense recorded for the management incentive agreement at Diodes-FabTech in 2003.

The effective tax rate in 2003 was 18.9% compared to 22.0% in 2002, due primarily to a higher proportion of income earned by our Asian subsidiaries in lower tax jurisdictions. The Company is benefiting from its Diodes-Hong Kong subsidiary, established in 2002, not only due to its lower tax rates, but also as another entry point into the Asia market. The Company recorded a provision for income taxes in the amount of \$2.5 million for the year 2003, compared to \$1.7 million for 2002. Included in the tax provision in 2003 is \$840,000 in deferred taxes recorded for a portion of the 2003 earnings at Diodes-China, and \$200,000 for a portion of the 2003 earnings at Diodes-Hong Kong.