

STMICROELECTRONICS NV

Form 20-F

March 14, 2007

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As filed with the Securities and Exchange Commission on March 14, 2007

**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 20-F**

- o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)
OF THE SECURITIES EXCHANGE ACT OF 1934
OR**
- p ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006
OR**
- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to**
- o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report**

**Commission file number: 1-13546
STMicroelectronics N.V.**

(Exact name of registrant as specified in its charter)

Not Applicable
*(Translation of registrant's
name into English)*

The Netherlands
*(Jurisdiction of incorporation
or organization)*

**39, Chemin du Champ des Filles
1228 Plan-Les-Ouates
Geneva
Switzerland**

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Name of Each Exchange on Which Registered:
Common shares, nominal value 1.04 per share	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

897,395,042 common shares at December 31, 2006

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

In this annual report or Form 20-F (the Form 20-F), references to we, us and Company are to STMicroelectronics N.V. together with its consolidated subsidiaries, references to EU are to the European Union, references to and the euro are to the euro currency of the EU, references to the United States and U.S. are to the United States of America and references to \$ or to U.S. dollars are to United States dollars. References to mm are to millimeters and references to nm are to nanometers.

We have compiled the market share, market size and competitive ranking data in this annual report using statistics and other information obtained from several third-party sources. Except as otherwise disclosed herein, all references to our competitive positions in this annual report are based on 2006 revenues according to provisional industry data published by iSuppli and 2005 revenues according to industry data published by iSuppli and Gartner, Inc., and references to trade association data are references to World Semiconductor Trade Statistics (WSTS). Certain terms used in this annual report are defined in Certain Terms .

We report our financial statements in U.S. dollars and prepare our consolidated financial statements in accordance with generally accepted accounting principles in the United States (U.S. GAAP). We also report certain non-U.S. GAAP financial measures (net operating cash flow and net financial position), which are derived from amounts presented in the financial statements prepared under U.S. GAAP. Furthermore, since 2005, we have been required by Dutch law to report our statutory and consolidated financial statements, previously reported using generally accepted accounting principles in the Netherlands, in accordance with International Financial Reporting Standards (IFRS). The financial statements reported in IFRS can differ materially from the statements reported in U.S. GAAP.

Various amounts and percentages used in this Form 20-F have been rounded and, accordingly, they may not total 100%.

We and our affiliates own or otherwise have rights to the trademarks and trade names, including those mentioned in this annual report, used in conjunction with the marketing and sale of our products.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Form 20-F that are not historical facts, particularly in Item 3. Key Information Risk Factors , Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects and Business Outlook , are statements of future expectations and other forward-looking statements (within the meaning of Section 27A of the Securities Act of 1933 or Section 21E of the Securities Exchange Act of 1934, each as amended) that are based on management's current views and assumptions, and are conditioned upon and also involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those in such statements due to, among other factors:

future developments of the world semiconductor market, in particular the future demand for semiconductor products in the key application markets and from key customers served by our products;

pricing pressures, losses or curtailments of purchases from key customers all of which are highly variable and difficult to predict;

the financial impact of obsolete or excess inventories if actual demand differs from our anticipations;

changes in the exchange rates between the U.S. dollar and the euro, and between the U.S. dollar and the currencies of the other major countries in which we have our operating infrastructure;

our ability to manage in an intensely competitive and cyclical industry where a high percentage of our costs are fixed and difficult to reduce in the short term, including our ability to adequately utilize and operate our manufacturing facilities at sufficient levels to cover fixed operating costs;

our ability to perform the announced strategic repositioning of our Flash memories business in line with the requirements of our customers and without adverse effect on existing alliances or other agreements relating to

this business;

our ability in an intensely competitive environment to secure customer acceptance and to achieve our pricing expectations for high volume supplies of new products in whose development we have or are currently investing;

the anticipated benefits of research and development alliances and cooperative activities, as well as the uncertainties concerning the modalities, conditions and financial impact beyond 2007 of the R&D and manufacturing activities in Crolles, following the termination of our current agreement with NXP Semiconductors and Freescale Semiconductor;

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the ability of our suppliers to meet our demands for supplies and materials and to offer competitive pricing;

significant variations in our gross margin compared to expectations could be the result of changes in revenue levels, product mix and pricing, capacity utilization, variations in inventory valuation, excess or obsolete inventory, manufacturing yields, changes in unit costs, impairments of long-lived assets, including manufacturing, assembly/test and intangible assets, and the timing and execution of the manufacturing ramp and associated costs, including start-up costs;

changes in the economic, social or political environment, including military conflict and/or terrorist activities, as well as natural events such as severe weather, health risks, epidemics or earthquakes in the countries in which we, our key customers and our suppliers operate;

changes in our overall tax position as a result of changes in tax laws or the outcome of tax audits, and our ability to accurately estimate tax credits, benefits, deductions and provisions and to realize deferred tax assets;

our ability to obtain required licenses on third-party intellectual property on reasonable terms and conditions, the impact of potential claims by third parties involving intellectual property rights relating to our business, and the outcome of litigation; and

the results of actions by our competitors, including new product offerings and our ability to react thereto.

Such forward-looking statements are subject to various risks and uncertainties, which may cause actual results and performance of our business to differ materially and adversely from the forward-looking statements. Certain forward-looking statements can be identified by the use of forward-looking terminology, such as *believes*, *expects*, *may*, *are expected to*, *will*, *will continue*, *should*, *would be*, *seeks* or *anticipates* or similar expressions thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans or intentions. Some of these risk factors are set forth and are discussed in more detail in *Item 3. Key Information Risk Factors*. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this Form 20-F as anticipated, believed or expected. We do not intend, and do not assume any obligation, to update any industry information or forward-looking statements set forth in this Form 20-F to reflect subsequent events or circumstances.

Unfavorable changes in the above or other factors listed under *Item 3. Key Information Risk Factors* from time to time in our Securities and Exchange Commission (*SEC*) filings, could have a material adverse effect on our business and/or financial condition.

Table of Contents**PART I****Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information**Selected Financial Data**

The table below sets forth our selected consolidated financial data for each of the years in the five-year period ended December 31, 2006. Such data have been derived from our consolidated financial statements. Consolidated audited financial statements for each of the years in the three-year periods ended December 31, 2006, including the Notes thereto (collectively, the Consolidated Financial Statements), are included elsewhere in this Form 20-F, while data for prior periods have been derived from our consolidated financial statements used in such periods.

The following information should be read in conjunction with Item 5. Operating and Financial Review and Prospects, the Consolidated Financial Statements and the related Notes thereto included in Item 8. Financial Information Financial Statements in this Form 20-F.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In millions except per share and ratio data)				
Consolidated Statement of Income Data:					
Net sales	\$ 9,838	\$ 8,876	\$ 8,756	\$ 7,234	\$ 6,270
Other revenues	16	6	4	4	48
Net revenues	9,854	8,882	8,760	7,238	6,318
Cost of sales	(6,331)	(5,845)	(5,532)	(4,672)	(4,020)
Gross profit	3,523	3,037	3,228	2,566	2,298
Operating expenses:					
Selling, general and administrative	(1,067)	(1,026)	(947)	(785)	(648)
Research and development(1)	(1,667)	(1,630)	(1,532)	(1,238)	(1,022)
Other income and expenses, net(1)	(35)	(9)	10	(4)	7
Impairment, restructuring charges and other related closure costs	(77)	(128)	(76)	(205)	(34)
Total operating expenses	(2,846)	(2,793)	(2,545)	(2,232)	(1,697)
Operating income	677	244	683	334	601
Interest income (expense), net	93	34	(3)	(52)	(68)
Loss on equity investments	(6)	(3)	(4)	(1)	(11)
Loss on extinguishment of convertible debt			(4)	(39)	
Income before income taxes and minority interests	764	275	672	242	522
Income tax benefit (expense)	20	(8)	(68)	14	(89)
Income before minority interests	784	267	604	256	433
Minority interests	(2)	(1)	(3)	(3)	(4)
Net income	\$ 782	\$ 266	\$ 601	\$ 253	\$ 429

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Earnings per share (basic)	\$ 0.87	\$ 0.30	\$ 0.67	\$ 0.29	\$ 0.48
Earnings per share (diluted)	\$ 0.83	\$ 0.29	\$ 0.65	\$ 0.27	\$ 0.48
Number of shares used in calculating earnings per share (basic)	896.1	892.8	891.2	888.2	887.6
Number of shares used in calculating earnings per share (diluted)	958.5	935.6	935.1	937.1	893.0

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	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In millions except per share and ratio data)				
Consolidated Balance Sheet Data (end of period):					
Cash and cash equivalents(2)	\$ 1,963	\$ 2,027	\$ 1,950	\$ 2,998	\$ 2,564
Marketable securities	460				
Short-term deposits	250				
Restricted cash for equity investments	218				
Total assets	14,198	12,439	13,800	13,477	12,004
Short-term debt (including current portion of long-term debt)	136	1,533	191	151	165
Long-term debt (excluding current portion)(2)	1,994	269	1,767	2,944	2,797
Shareholders' equity(2)	9,747	8,480	9,110	8,100	6,994
Capital stock(3)	3,177	3,120	3,074	3,051	3,008
Other Data:					
Dividends per share	\$ 0.12	\$ 0.12	\$ 0.12	\$ 0.08	\$ 0.04
Capital expenditures(4)	1,533	1,441	2,050	1,221	995
Net cash provided by operating activities	2,491	1,798	2,342	1,920	1,713
Depreciation and amortization(4)	1,766	1,944	1,837	1,608	1,382
Net debt (cash) to total shareholders' equity ratio(5)	(0.078)	(0.026)	0.001	0.012	0.057

- (1) Other income and expenses, net includes, among other things, funds received through government agencies for research and development expenses, the cost of new production facilities start-ups, foreign currency gains and losses, gains on sales of marketable securities and non-current assets and the costs of certain activities relating to intellectual property. Our reported research and development expenses are mainly in the areas of product design, technology and development, and do not include marketing design center costs, which are accounted for as selling expenses, or process engineering, pre-production and process-transfer costs, which are accounted for as cost of sales.
- (2) On November 16, 2000, we issued \$2,146 million initial aggregate principal amount of zero-coupon senior convertible bonds due 2010 (the 2010 Bonds), for net proceeds of \$1,458 million; in 2003, we repurchased on the market approximately \$1,674 million aggregate principal amount at maturity of 2010 Bonds. During 2004, we completed the repurchase of our 2010 Bonds and repurchased on the market approximately \$472 million aggregate principal amount at maturity for a total amount paid of \$375 million. In 2001, we redeemed the remaining \$52 million of our outstanding Liquid Yield Option Notes due 2008 (our 2008 LYONs) and converted them into common shares in May and June 2001. In 2001, we repurchased 9,400,000 common shares for \$233 million, and in 2002, we repurchased an additional 4,000,000 shares for \$115 million. We reflected these purchases at cost as a reduction of shareholders' equity. The repurchased shares have been designated to fund share compensation granted to employees under our 2001 employee stock plan and may be used for subsequent grants. In 2006, 637,109 shares were transferred to employees upon vesting of stock awards. In August 2003, we issued \$1,332 million principal amount at maturity of our convertible bonds due 2013 (our 2013 Convertible Bonds) with a negative yield of 0.5% that resulted in a higher principal amount at issuance of \$1,400 million and net proceeds of \$1,386 million. During 2004, we repurchased all of our outstanding Liquid Yield Option Notes due 2009 (our 2009 LYONs) for a total amount of cash paid of \$813 million. In February 2006, we issued Zero Coupon Senior

Convertible Bonds due 2016 (our 2016 Convertible Bonds) representing total gross proceeds of \$974 million. In March 2006, we issued 500 million Floating Rate Senior Bonds due 2013 (our 2013 Senior Bonds). In August 2006, as a result of almost all of the holders of our 2013 Convertible Bonds exercising their August 4, 2006 put option, we repurchased \$1,397 million aggregate principal amount of the outstanding convertible bonds at a conversion ratio of \$985.09 per \$1,000 aggregate principal amount at issuance resulting in a cash disbursement of \$1,377 million.

- (3) Capital stock consists of common stock and capital surplus.
- (4) Capital expenditures are net of certain funds received through government agencies, the effect of which is to decrease depreciation.
- (5) Net debt (cash) to total shareholders equity ratio is a non-U.S. GAAP financial measure. The most directly comparable U.S. GAAP financial measure is considered to be Debt-to-Equity Ratio . However, the Debt-to-Equity Ratio measures gross debt relative to equity, and does not reflect the current cash position of the Company. We believe that our net debt (cash) to total shareholders equity ratio is useful to investors as a measure of our financial position and leverage. The ratio is computed on the basis of our net financial position divided by total shareholders equity. Our net financial position is the difference between our total cash position (cash and cash equivalents, marketable securities, short-term deposits and restricted cash) net of total financial debt (bank overdrafts, current portion of long-term debt and long-term debt). For more information on our net financial position, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Capital Resources Net financial position . Our computation of net debt (cash) to total shareholders equity ratio may not be consistent with that of other companies, which could make comparability difficult.

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The semiconductor industry is cyclical and downturns in the semiconductor industry can negatively affect our results of operations and financial condition.

The semiconductor industry is cyclical and has been subject to significant economic downturns at various times. Downturns are typically characterized by diminished demand giving rise to production overcapacity, accelerated erosion of average selling prices, high inventory levels and reduced revenues. Downturns may be the result of industry-specific factors, such as excess capacity, product obsolescence, price erosion, evolving standards, changes in end-customer demand, and/or macroeconomic trends impacting the economies of one or more of the world's major regions: Asia, the United States, Europe and Japan. Such macroeconomic trends relate to the semiconductor industry as a whole and not necessarily to the individual semiconductor markets to which we sell our products. The negative effects on our business from industry downturns may also be increased to the extent that such downturns are concurrent with the timing of new increases in production capacity in our industry.

We have experienced revenue volatility and market downturns in the past and expect to experience downturns them in the future, which could have a material adverse impact on our results of operations and financial condition.

Increases in production capacity for semiconductor products may lead to overcapacity, which in turn may lead to plant closures, asset impairments, restructuring charges and inventory write-offs.

Capital investments for semiconductor manufacturing equipment are made both by integrated semiconductor companies like us and by specialist semiconductor foundry companies, which are subcontractors that manufacture semiconductor products designed by others.

According to data published by industry sources, investments in worldwide semiconductor fabrication capacity totaled approximately \$37.7 billion in 2001, \$26.1 billion in 2002, \$29.5 billion in 2003, \$45.7 billion in 2004, \$46.1 billion in 2005 and an estimated \$55 billion in 2006, or approximately 27%, 19%, 18%, 22%, 20% and 23%, respectively, of the total available market for these years. The net increase of manufacturing capacity, defined as the difference between capacity additions and capacity reductions, may exceed demand requirements, leading to overcapacity and price erosion.

Overcapacity and cost optimization have led us, in recent years, to close manufacturing facilities that used more mature process technologies and, as a result, to incur significant impairment, restructuring charges and related closure costs. In 2006, we recorded impairment, restructuring charges and related closure costs of \$77 million. See Item 5. Operating and Financial Review and Prospects—Impairment, Restructuring Charges and Other Related Closure Costs.

As of December 31, 2006, the 2005 restructuring plan was substantially completed and had resulted in total charges of approximately \$73 million for intangible assets and goodwill mainly related to the CPE product lines and \$86 million for headcount restructuring charges, out of an estimated \$175 million. Through the period ended December 31, 2006, we have incurred \$316 million of the total expected of approximately \$330 million in pre-tax charges associated with the 150-mm restructuring plan, slightly down from the original estimate of \$350 million that was defined on October 22, 2003, and which was substantially completed by the end of 2006.

There can be no assurance that future changes in the market demand for our products, overcapacity, obsolescence in our manufacturing facilities and market downturns may not require us to lower the prices we charge for our products as well as incur additional impairment and restructuring charges, which may have a material adverse effect on our business, financial condition and results of operations.

Competition in the semiconductor industry is intense, and we may not be able to compete successfully if our product design technologies, process technologies and products do not meet market requirements.

We compete in different product lines to various degrees on the following characteristics:

price;

technical performance;

product features;

product system compatibility;

product design and technology;

timely introduction of new products;

product availability;

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manufacturing yields; and

sales and technical support.

We face significant competition in each of our product lines. Like us, many of our competitors also offer a large variety of products. Some of our competitors may have greater financial and/or more focused research and development resources than we do. If these competitors substantially increase the resources they devote to developing and marketing products that compete with ours, we may not be able to compete successfully. Any consolidation among our competitors could also enhance their product offerings, manufacturing efficiency and financial resources, further strengthening their competitive position.

Given the intense competition in the semiconductor industry, if our products are not selected based on any of the above factors, our business, financial condition and results of operations could be materially adversely affected.

In many of the market segments in which we compete for business, competition for the selection of suppliers to design products for use in our customers' equipment and products is very intense, and failure to be selected or to execute could materially adversely affect our business in that market segment. Even after we win and begin a product design, a customer may cancel or change its product plans, which could cause us to generate no sales from a product, resulting in a materially adverse affect on our results of operations and financial condition.

We regularly devote substantial resources to winning competitive bid selection processes, known as product design wins, to develop products for use in our customers' equipment and products. These selection processes can be lengthy and can require us to incur significant design and development expenditures, with no guarantee of winning or generating revenue. Delays in developing new products with anticipated technological advances and failure to win new design projects for customers or in commencing volume shipments of new products may have an adverse effect on our business. In addition, there can be no assurance that new products, if introduced, will gain market acceptance or will not be adversely affected by new technological changes or new product announcements by other competitors that may have greater resources or are more focused than we are. Because we typically focus on only a few customers in a product area, the loss of a design win can sometimes result in our failure to offer a generation of a product. This can result in lost sales and could hurt our position in future competitive selection processes because we may be perceived as not being a technology or industry leader.

Even after obtaining a product design win from one of our customers, we may still experience delays in generating revenue from our products as a result of the customer's or our lengthy development and design cycle. In addition, a delay or cancellation of a customer's plans could significantly adversely affect our financial results, as we may have incurred significant expense and generated no revenue at the time of such delay or cancellation. Finally, if our customers fail to successfully market and sell their own products, it could materially adversely affect our business, financial condition and results of operations as the demand for our products falls.

Semiconductor and other products that we design and manufacture are characterized by rapidly changing technology and new product introductions, and our success depends on our ability to develop and manufacture complex products cost-effectively and to scale.

Semiconductor design and process technologies are subject to constant technological improvements and require large expenditures for capital investments, advanced research and technology development. Many of the resulting products that we market, in turn, have short life cycles, with some being less than one year.

If we experience substantial delays or are unable to develop new design or process technologies, our results of operations or financial condition could be adversely affected.

We also regularly incur costs to acquire technology from third parties without any guarantee of realizing the anticipated value of such expenditures due to changes in other available technologies or market demand. For example, we charged \$52 million as annual amortization expense on our consolidated statement of income in 2006 related to technologies and licenses acquired from third parties through the end of 2006. As of December 31, 2006, the residual value, net of amortization, registered in our consolidated balance sheet for these technologies and licenses was \$95 million. In addition to amortization expenses, the value of these assets may be subject to impairment with associated charges being made to our consolidated financial statements.

The competitive environment of the semiconductor industry may lead to further measures to improve our competitive position and cost structure, which in turn may result in loss of revenues, asset impairments and/or capital losses.

We are continuously considering various measures to improve our competitive position and cost structure in the semiconductor industry. In February 2005, we decided to stop work on a reference design chipset for the

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GSM/ GPRS market and announced plans to reduce our Access technology programs for CPE products. In May 2005, we announced additional restructuring efforts to improve profitability. For the years 2003 through 2005, our sales increased at a slower pace than the semiconductor industry as a whole and our market share declined, although we recovered in 2006 with an increase in our sales of 11% compared to an increase of 9% for the industry overall. There is no assurance that we will continue to grow our market share, if we are not able to accelerate product innovation, extend our customer base, realize manufacturing improvements and/or otherwise control our costs. In addition, in recent years the semiconductor industry has continued to increase manufacturing capacity in Asia in order to access lower-cost production and to benefit from higher overall efficiency, which has led to a stronger competitive environment. We may also in the future, if we consider that market conditions so require, consider additional measures to improve our cost structure and competitiveness in the semiconductor market, such as increasing our production capacity in Asia or a discontinuation of certain product families or additional restructurings, which in turn may result in loss of revenues, asset impairments and/or capital losses.

Risks Related to Our Operations

Our research and development efforts are increasingly expensive and dependent on alliances, and our business, results of operations and prospects could be materially adversely affected by the failure or termination of such alliances, or failure to find new partners in such alliances, in developing new process technologies in line with market requirements.

We are dependent on alliances to develop or access new technologies and there can be no assurance that these alliances will be successful or that our partners will continue to participate in the alliances. For example, we are currently cooperating with Freescale Semiconductor, Inc. (formerly a division of Motorola Inc.) (Freescale Semiconductor) and NXP Semiconductors B.V. (formerly Philips Semiconductor International B.V.) (NXP Semiconductors) for the joint research and development of CMOS process technology to provide 90-nm to 32-nm chip technologies on 300-mm wafers, as well as the operation of a 300-mm wafer pilot line fab in Crolles, France (Crolles2). We initially formed the Crolles2 alliance with NXP Semiconductors in 2000 and renewed the partnership in 2002 when Freescale Semiconductor joined the alliance. The Crolles2 alliance was also extended in 2002 through a joint development program with TSMC for process technology alignment, in 2004 by the Nanotec-300 research program with CEA-LETI for the development of the 45-nm and 32-nm process technology nodes, and again in 2005 by including 300-mm wafer testing and packaging, as well as the development and licensing of core libraries and IP.

In January 2007, NXP Semiconductors announced that it will withdraw from the alliance at the end of 2007 and therefore our Crolles2 alliance will expire on December 31, 2007. Freescale Semiconductor has also notified us that the Crolles2 alliance will terminate as of such date. There can be no assurance that we will be successful in finding new partners to pursue joint R&D work and/or joint manufacturing production at Crolles2 beyond 2007. In addition, the termination of our R&D alliance in Crolles2 with Freescale Semiconductor and NXP Semiconductors may significantly increase our future cost and capital requirements to access advanced CMOS process technologies and proprietary state-of-the-art derivative CMOS technologies, and the operation of our Crolles2 manufacturing facility.

We continue to believe that the shared R&D business model contributes to the fast acceleration of semiconductor process technology development while allowing us to lower our development and manufacturing costs. However, there can be no assurance that alliances will be successful or that new alliances will be concluded to allow us to develop and access new technologies in due time, in a cost-effective manner and/or to meet customer demands. Furthermore, if these alliances terminate before our intended goals are accomplished we may lose our investment, or incur additional unforeseen costs, and our business, results of operations and prospects could be materially adversely affected. In addition, if we are unable to develop or otherwise access new technologies independently, we may fail to keep pace with the rapid technology advances in the semiconductor industry, our participation in the overall semiconductor industry may decrease and we may also lose market share in the market addressed by our products.

In difficult market conditions, our high fixed costs adversely impact our results.

In less favorable industry environments, we are driven to reduce prices in response to competitive pressures and we are also faced with a decline in the utilization rates of our manufacturing facilities due to decreases in product

demand. Since the semiconductor industry is characterized by high fixed costs, we are not always able to reduce our total costs in line with revenue declines. Reduced average selling prices for our products, therefore adversely affect our results of operations. Furthermore, in periods of reduced customer demand for our products, our wafer fabrication plants (fabs) do not operate at full capacity and the costs associated with the excess capacity are charged directly to cost of sales. Over the last five years, our gross profit margin has varied from a high of 37.9% in the third quarter of 2004 to a low of 32.9% in the first quarter of 2005. We cannot guarantee that

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difficult market conditions will not adversely affect the capacity utilization of our fabs and, consequently our future gross margins. We cannot guarantee that increased competition in our core product markets will not lead to further price erosion, lower revenue growth rates and lower margins in the future.

The competitive environment of the semiconductor industry has led to industry consolidation and we may face even more intense competition from newly merged competitors or we may seek to acquire a competitor or become an acquisition target.

The intensely competitive environment of the semiconductor industry and the high costs associated with developing marketable products and manufacturing technologies may lead to further consolidation in the industry. Such consolidation can allow a company to further benefit from economies of scale, provide improved or more diverse product portfolios and increase the size of its serviceable market. Consequently, we may seek to acquire a competitor to improve our market position and the applications and products we can market. We also may become a target for a company looking to improve its competitive position. Such an occurrence may take place at any time with consequences that may not be predictable and which can have a materially adverse effect on our results of operations and financial condition.

Future acquisitions or divestitures may adversely affect our business.

Our strategies to improve our results of operations and financial condition may lead us to make significant acquisitions of businesses that we believe to be complementary to our own, or to divest ourselves of activities that we believe do not serve our longer term business plans. In addition, certain regulatory approvals for potential acquisitions may require the divestiture of business activities.

Our potential acquisition strategies depend in part on our ability to identify suitable acquisition targets, finance their acquisition and obtain required regulatory and other approvals. Our potential divestiture strategies depend in part on our ability to define the activities in which we should no longer engage, and then determine and execute appropriate methods to divest of them.

Acquisitions and divestitures involve a number of risks that could adversely affect our operating results, including:

- diversion of management's attention;

- difficult integration of acquired company operations and personnel;

- loss of activities and technologies that may have complemented our remaining businesses;

- assumption of potential liabilities, disclosed or undisclosed, associated with the business acquired, which liabilities may exceed the amount of indemnification available from the seller;

- potential inaccuracies in the financial and accounting systems utilized by the business acquired;

- that the businesses acquired will not maintain the quality of products and services that we have historically provided;

- whether we are able to attract and retain qualified management for the acquired business;

- loss of important services provided by key employees that are assigned to divested activities;

- whether we are able to retain customers of the acquired entity; and

- goodwill and other intangible asset impairment, due to the inability of the business to meet management's expectations at the time of the acquisition.

These and other factors may cause a materially adverse effect on our results of operations and financial condition.

The strategic repositioning of our memory business may fail to produce the operational and strategic benefits which we envisioned.

As a result of a strategic review of our product portfolio, we decided to actively pursue solutions aimed at strengthening the competitive position of our memory business by deconsolidating that segment from our financial results, and, if possible, participate in industry consolidation. Consequently, on December 13, 2006, we announced plans to create a stand-alone Flash Memories Group. The Flash Memories Group incorporates all Flash memory operations, including research and development and product-related activities, front- and back-end manufacturing, marketing and sales. Our initiative is intended to result in a number of strategic benefits, including the ability to benefit from increased scale and employee incentives more directly tied to our financial performance. This initiative may not produce the anticipated benefits, which could adversely affect the results of our operations and future capital requirements. It may also lead to disadvantages, including but not limited to a

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loss of synergies, economies of scale and one-time or ongoing losses that are not fully offset by any expected benefits.

Furthermore, we have a joint development agreement with Hynix Semiconductor Inc. (Hynix Semiconductor) for the development of NAND Flash memories and a joint venture agreement with Hynix Semiconductor for the building and operation of a front-end memory manufacturing facility in Wuxi City, China.

In addition, we are building a new facility in Catania M6, where facilitization is nearly completed and where we carry approximately \$400 million in assets, but which remains to be equipped. Realization of the anticipated benefits depend on the development of future partnerships in the Flash memories business. Future capital investments for this facility should benefit from certain public funding, which has been recently approved by the requisite European Union and Italian authorities. In case the repositioning of our memory business results in a change of control, such business would cease to benefit from those of our agreements which apply only to the subsidiaries in which we have a minimum 50% controlling interest, and our assets value and results of operations may suffer a material adverse effect pursuant to such change of control.

Our financial results can be adversely affected by fluctuations in exchange rates, principally in the value of the U.S. dollar.

A significant variation of the value of the U.S. dollar against the principal currencies which have a material impact on us (primarily the euro, but also certain other currencies of countries where we have operations) could result in a favorable impact on our net income in the case of an appreciation of the U.S. dollar, or a negative impact on our net income if the U.S. dollar depreciates relative to these currencies. Currency exchange rate fluctuations affect our results of operations because our reporting currency is the U.S. dollar, in which we receive the major part of our revenues, while, more importantly, we incur the majority of our costs in currencies other than the U.S. dollar. Certain significant costs incurred by us, such as manufacturing labor costs and depreciation charges, selling, general and administrative expenses, and research and development expenses, are incurred in the currencies of the jurisdictions in which our operations are located.

In order to reduce the exposure of our financial results to the fluctuations in exchange rates, our principal strategy has been to balance as much as possible the proportion of sales to our customers denominated in U.S. dollars with the amount of purchases from our suppliers denominated in U.S. dollars and to reduce the weight of the other costs, including labor costs and depreciation, denominated in euros and in other currencies. In order to further reduce our exposure to U.S. dollar exchange rate fluctuations, we have hedged certain line items on our income statement, in particular with respect to a portion of the cost of goods sold, most of the research and development expenses and certain selling and general and administrative expenses located in the euro zone. No assurance can be given that the value of the U.S. dollar will not actually appreciate with the hedging transaction potentially preventing us from benefiting from lower euro-denominated manufacturing costs when translated into our U.S. dollar-based accounts. See Item 5. Operating and Financial Review and Prospects Impact of Changes in Exchange Rates and Item 11. Quantitative and Qualitative Disclosures About Market Risk .

Our Consolidated Financial Statements for 2006 include income and expense items translated at the average rate for the period. In 2006, our effective average U.S. dollar exchange rate, which reflects the current exchange rate levels and the impact of our hedging contracts, was 1.00 for \$1.24, compared to our effective average exchange rate of 1.00 for \$1.28 in 2005.

A decline of the U.S. dollar compared to the other major currencies that affect our operations negatively impacts our expenses, margins and profitability, especially if we are unable to balance or shift our euro-denominated costs to other currency areas or to U.S. dollars. Any such actions may not be immediately effective, could prove costly, and their implementation could prove demanding on our management resources.

Because we have our own manufacturing facilities, our capital needs are high compared to competitors who do not produce their own products.

As a result of our strategic choice to maintain control of our advanced proprietary manufacturing technologies to serve our customer base and develop our strategic alliances, we require significant amounts of capital to build, expand, modernize and maintain our facilities. Some of our competitors, however, do not manufacture their own products and therefore do not require significant capital expenditures for their facilities. Our capital expenditures have

been significant in recent years and we spent \$1.5 billion in 2006. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources . We have evolved our strategy towards a less capital intensive structure and as such we expect our capital expenditures to be \$1.2 billion in 2007. Our costs may also increase as the complexity of the individual manufacturing equipment increases. We have the flexibility to modulate our investments up or down in response to changes in market conditions, and we are prepared to accelerate investments in leading-edge technologies if market conditions require.

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To stay competitive in the semiconductor industry, we must transition certain products to 300-mm manufacturing technology, which is much more expensive than 150-mm or 200-mm technologies. Currently, all of our fabs process wafers with diameters of 150-mm or 200-mm and we are running a 300-mm pilot line at Crolles2, with our partners NXP Semiconductors and Freescale Semiconductor. This relationship will expire at December 31, 2007. There is no assurance that we will be successful in finding alternative partnership opportunities to replace the loading currently supported by NXP Semiconductors and Freescale Semiconductor in Crolles2, which in turn may lead to increased capital commitments and manufacturing costs. We have also constructed a building in Catania (Italy), which is not yet equipped, for the volume production of 300-mm wafers, which has been allocated to our new Flash Memories Group. In addition, we have a 33% equity interest in a joint venture company with Hynix Semiconductor, which has built a new 300-mm fab for the production of NAND memory products in Wuxi, China. Since the joint venture is planning to expand its activity, we may be required to make an additional capital investment to keep this level of equity interest in the joint venture.

The construction, facilitization or equipment of state-of-the-art manufacturing facilities may require us to issue additional debt or equity, or both, and if we are unable to access such capital on acceptable terms, this may adversely affect our business and results of operations. The timing and size of any new share, convertible bond or straight bond offering would depend upon market conditions as well as a variety of factors, and any such transaction or any announcement concerning such a transaction could materially impact the market price of our common shares.

We may also need additional funding in the coming years to finance our investments or to purchase other companies or technologies developed by third parties.

In an increasingly complex and competitive environment, we may need to invest in other companies and/or in technology developed by third parties to improve our position in the market. We may also consider acquisitions to complement or expand our existing business. Furthermore, we may need to rely on public funding as we transition to 300-mm manufacturing technology. We are dependent on public funding for equipping the 300-mm wafer production facility in Catania (Italy) and there can be no assurance that we will obtain this public funding, as planned, or that we will be in a position to utilize the funding within the planned time frame. If such planned funding does not materialize, we may lack financial resources to continue with our investment plan for this facility, which in turn could lead us to discontinue our investment in such facility and consequently incur significant impairments. Any of the foregoing may also require us to issue additional debt, equity, or both. If we are unable to access such capital on acceptable terms, this may adversely affect our business and results of operations. Existing loan agreements for local funding of our Singapore and China legal entities contain financial covenants.

Our operating results may vary significantly from quarter to quarter and annually and may differ significantly from our expectations or guidance.

Our operating results are affected by a wide variety of factors that could materially and adversely affect revenues and profitability or lead to significant variability of operating results. These factors include, among others, the cyclicity of the semiconductor and electronic systems industries, capital requirements, inventory management, availability of funding, competition, new product developments, technological changes and manufacturing problems. Furthermore, our effective tax rate currently takes into consideration certain favorable tax rates and incentives, which, in the future, may not be available to us. See Note 22 to our Consolidated Financial Statements. In addition, a number of other factors could lead to fluctuations in quarterly and annual operating results, including:

performance of our key customers in the markets they serve;

order cancellations or reschedulings by customers;

excess inventory held by customers leading to reduced bookings or product returns by key customers;

manufacturing capacity and utilization rates;

restructuring and impairment charges;

fluctuations in currency exchange rates, particularly between the U.S. dollar and other currencies in jurisdictions where we have activities;

intellectual property developments;

changes in distribution and sales arrangements;

failure to win new design projects;

manufacturing performance and yields;

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product liability or warranty claims;

litigation;

acquisitions or divestitures;

problems in obtaining adequate raw materials or production equipment on a timely basis; and

property damage or business interruption losses resulting from a catastrophic event not covered by insurance.

Unfavorable changes in any of the above factors have in the past and may in the future adversely affect our operating results. Furthermore, in periods of industry overcapacity or when our key customers encounter difficulties in their end markets, orders are more exposed to cancellations, reductions, price renegotiation or postponements, which in turn reduce our management's ability to forecast the next quarter or full year production levels, revenues and margins. For these reasons and others that we may not yet have identified, our revenues and operating results may differ materially from our expectations or guidance as visibility is reduced. See Item 4. Information on the Company Backlog .

Our business is dependent in large part on continued growth in the industries and segments into which our products are sold and in our ability to attract and retain new customers. A market decline in any of these industries or our inability to attract new customers could have a material adverse effect on our results of operations.

We derive and expect to continue to derive significant sales from the telecommunications equipment and automotive industries, as well as the home, personal and consumer segments generally. Growth of demand in the telecommunications equipment and automotive industries as well as the home, personal and consumer segments, has in the past fluctuated, and may in the future fluctuate, significantly based on numerous factors, including:

spending levels of telecommunications equipment and/or automotive providers;

development of new consumer products or applications requiring high semiconductor content;

evolving industry standards;

the rate of adoption of new or alternative technologies; and

demand for automobiles, consumer confidence and general economic conditions.

We cannot guarantee the rate, or the extent to which, the telecommunications equipment or automotive industries or the home, personal or consumer segments will grow, if at all. Any decline in these industries or segments could result in slower growth or a decline in demand for our products, which could have a material adverse effect on our business, financial condition and results of operations.

In addition, projected industry growth rates may not materialize as forecasted, resulting in spending on process and product development well ahead of market requirements, which could have a material adverse effect on our business, financial condition and results of operations.

Our business is dependent upon our ability to attract and retain new customers. The competition for such new customers is intense. There can be no assurance that we will be successful in attracting and retaining new customers. Our failure to do so could materially adversely affect our business, financial position and results of operations.

Disruptions in our relationships with any one of our key customers could adversely affect our results of operations.

A substantial portion of our sales is derived from several large customers, some of whom have entered into strategic alliances with us. As of December 31, 2006, our largest customer was Nokia, which accounted for 21.8% of our 2006 net revenues, compared to 22.4% in 2005 and 17.1% in 2004. In 2006, our top ten OEM customers accounted for approximately 51% of our net revenues, compared to approximately 50% of our 2005 net revenues and

44% of our 2004 net revenues. We cannot guarantee that our largest customers will continue to book the same level of sales with us that they have in the past and will not solicit alternative suppliers. Many of our key customers operate in cyclical businesses that are also highly competitive, and their own demands and market positions may vary considerably. Such customers have in the past, and may in the future, vary order levels significantly from period to period, request postponements to scheduled delivery dates or modify their bookings. Approximately 19% of our net revenues were made through distributors in 2006, compared to approximately 18% in 2005 and approximately 21% in 2004. We cannot guarantee that we will be able to maintain or enhance our market share with our key customers or distributors. If we were to lose one or more design wins for our products with our key customers or distributors, or if any key customer were to reduce or change its bookings,

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seek alternate suppliers, increase its product returns or fail to meet its payment obligations, our business financial condition and results of operations could be materially adversely affected. If customers do not purchase products made specifically for them, we may not be able to resell such products to other customers or require the customers who have ordered these products to pay a cancellation fee. Furthermore, developing industry trends, including customers' use of outsourcing and new and revised supply chain models, may reduce our ability to forecast the purchase date for our products and evolving customer demand, thereby affecting our revenues and working capital requirements. For example, pursuant to industry developments, some of our products are required to be delivered on consignment to customer sites with recognition of revenue delayed until such time, which must occur within a defined period of time, when the customer chooses to take delivery of our products from our consignment stock.

Our operating results can also vary significantly due to impairment of goodwill and other intangible assets incurred in the course of acquisitions, as well as to impairment of tangible assets due to changes in the business environment.

Our operating results can also vary significantly due to impairment of goodwill booked pursuant to acquisitions and to the purchase of technologies and licenses from third parties. As of December 31, 2006, the value registered on our audited consolidated balance sheet for goodwill was \$223 million and the value for technologies and licenses acquired from third parties was \$95 million, net of amortization. Because the market for our products is characterized by rapidly changing technologies, and because of significant changes in the semiconductor industry, our future cash flows may not support the value of goodwill and other intangibles registered in our balance sheet. Furthermore, the ability to generate revenues for our fixed assets located in Europe may be impaired by an increase in the value of the euro with respect to the U.S. dollar, as the revenues from the use of such assets are generated in U.S. dollars. We are required to annually test goodwill and to assess the carrying values of intangible and tangible assets when impairment indicators exist. As a result of such tests, we could be required to book impairment in our statement of income if the carrying value in our balance sheet is in excess of the fair value. The amount of any potential impairment is not predictable as it depends on our estimates of projected market trends, results of operations and cash flows. Any potential impairment, if required, could have a material adverse impact on our results of operations.

Because we depend on a limited number of suppliers for raw materials and certain equipment, we may experience supply disruptions if suppliers interrupt supply or increase prices.

Our ability to meet our customers' demand to manufacture our products depends upon obtaining adequate supplies of quality raw materials on a timely basis. A number of materials are available only from a limited number of suppliers, or only from a limited number of suppliers in a particular region. In addition, we purchase raw materials such as silicon wafers, lead frames, mold compounds, ceramic packages and chemicals and gases from a number of suppliers on a just-in-time basis, as well as other materials such as copper and gold whose prices on the world markets have fluctuated significantly during recent periods. Although supplies for the raw materials we currently use are adequate, shortages could occur in various essential materials due to interruption of supply or increased demand in the industry. In addition, the costs of certain materials, such as copper and gold, may increase due to market pressures and we may not be able to pass on such cost increases to the prices we charge to our customers. We also purchase semiconductor manufacturing equipment from a limited number of suppliers and because such equipment is complex it is difficult to replace one supplier with another or to substitute one piece of equipment for another. In addition, suppliers may extend lead times, limit our supply or increase prices due to capacity constraints or other factors. Furthermore, suppliers tend to focus their investments on providing the most technologically advanced equipment and materials and may not be in a position to address our requirements for equipment or materials of older generations. Shortages of supplies have in the past impacted and may in the future impact the semiconductor industry, in particular with respect to silicon wafers due to increased demand and decreased production. Although we work closely with our suppliers to avoid these types of shortages, there can be no assurances that we will not encounter these problems in the future. Our quarterly or annual results of operations would be adversely affected if we were unable to obtain adequate supplies of raw materials or equipment in a timely manner or if there were significant increases in the costs of raw materials or problems with the quality of these raw materials.

Our manufacturing processes are highly complex, costly and potentially vulnerable to impurities, disruptions or inefficient implementation of production changes that can significantly increase our costs and delay product shipments to our customers.

Our manufacturing processes are highly complex, require advanced and increasingly costly equipment and are continuously being modified or maintained in an effort to improve yields and product performance. Impurities or other difficulties in the manufacturing process can lower yields, interrupt production or result in losses of

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products in process. As system complexity and production changes have increased and sub-micron technology has become more advanced, manufacturing tolerances have been reduced and requirements for precision have become even more demanding. Although in the past few years we have significantly enhanced our manufacturing capability in terms of efficiency, precision and capacity, we have from time to time experienced bottlenecks and production difficulties that have caused delivery delays and quality control problems, as is common in the semiconductor industry. We cannot guarantee that we will not experience bottlenecks, production or transition difficulties in the future. In addition, during past periods of high demand for our products, our manufacturing facilities have operated at high capacity, which has led to production constraints. Furthermore, if production at a manufacturing facility is interrupted, we may not be able to shift production to other facilities on a timely basis, or customers may purchase products from other suppliers. In either case, the loss of revenue and damage to the relationship with our customer could be significant. Furthermore, we periodically transfer production equipment between production facilities and must ramp up and test such equipment once installed in the new facility before it can reach its optimal production level.

As is common in the semiconductor industry, we have, from time to time, experienced and may in the future experience difficulties in transferring equipment between our sites, ramping up production at new facilities or effecting transitions to new manufacturing processes. Our operating results may be adversely affected by an increase in fixed costs and operating expenses linked to production if revenues do not increase commensurately with such fixed costs and operating expenses.

We may be faced with product liability or warranty claims.

Despite our corporate quality programs and commitment, our products may not in each case comply with specifications or customer requirements. Although our practice, in line with industry standards, is to contractually limit our liability to the repair, replacement or refund of defective products, warranty or product liability claims could result in significant expenses relating to compensation payments or other indemnification to maintain good customer relationships. Furthermore, we could incur significant costs and liabilities if litigation occurs to defend against such claims and if damages are awarded against us. In addition, it is possible for one of our customers to recall a product containing one of our parts. Costs or payments we may make in connection with warranty claims or product recalls may adversely affect our results of operations. There is no guarantee that our insurance policies will be available or adequate to protect against all such claims.

If our outside foundry suppliers fail to perform, this could adversely affect our ability to exploit growth opportunities.

We currently use outside suppliers or foundries primarily for high-speed complementary metal-on silicon oxide semiconductor (HCMOS) wafers and nonvolatile memory technology. If our outside suppliers are unable to satisfy our demand, or experience manufacturing difficulties, delays or reduced yields, our results of operations and ability to satisfy customer demand could suffer. In addition, purchasing rather than manufacturing these products may adversely affect our gross profit margin if the purchase costs of these products are higher than our own manufacturing costs. Our internal manufacturing costs include depreciation and other fixed costs, while costs for products outsourced are based on market conditions. Prices for foundry products also vary depending on capacity utilization rates at our suppliers, quantities demanded, product technology and geometry. Furthermore, these outsourcing costs can vary materially from quarter to quarter and, in cases of industry shortages, they can increase significantly further, negatively impacting our gross margin.

We depend on patents to protect our rights to our technology.

We depend on our ability to obtain patents and other intellectual property rights covering our products and their design and manufacturing processes. We intend to continue to seek patents on our inventions relating to product designs and manufacturing processes. However, the process of seeking patent protection can be long and expensive, and we cannot guarantee that we will receive patents from currently pending or future applications. Even if patents are issued, they may not be of sufficient scope or strength to provide meaningful protection or any commercial advantage. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in some countries. Competitors may also develop technologies that are protected by patents and other intellectual property and therefore

either be unavailable to us or be made available to us subject to adverse terms and conditions. We have in the past used our patent portfolio to negotiate broad patent cross-licenses with many of our competitors enabling us to design, manufacture and sell semiconductor products, without fear of infringing patents held by such competitors. We may not, however, in the future be able to obtain licenses or other rights to protect necessary intellectual property on acceptable terms for the conduct of our business, and such failure may adversely impact our results of operations.

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We have from time to time received, and may in the future receive, communications alleging possible infringement of patents and other intellectual property rights. Furthermore, we may become involved in costly litigation brought against us regarding patents, mask works, copyrights, trademarks or trade secrets. We are currently involved in patent litigation with SanDisk Corporation with respect to our Flash memory products and in litigation with Tessera, Inc. regarding packaging technologies. See Item 8. Financial Information Legal Proceedings . In the event that the outcome of any litigation would be unfavorable to us, we may be required to obtain a license to the underlying intellectual property rights upon economically unfavorable terms and conditions, possibly pay damages for prior use and/or face an injunction, all of which, singly or in the aggregate, could have a material adverse effect on our results of operations and ability to compete.

Finally, litigation could cost us financial and management resources necessary to enforce our patents and other intellectual property rights or to defend against third party intellectual property claims, when we believe that the amounts requested for a license are unreasonable.

Some of our production processes and materials are environmentally sensitive, which could lead to increased costs due to environmental regulations or to damage to the environment.

We are subject to a variety of laws and regulations relating, among other things, to the use, storage, discharge and disposal of chemicals, gases and other hazardous substances used in our manufacturing processes, air emissions, waste water discharges, waste disposal, as well as the investigation and remediation of soil and ground water contamination. European Directive 2002/96/ EC (WEEE Directive) imposes a take back obligation on manufacturers for the financing of the collection, recovery and disposal of electrical and electronic equipment. Additionally, European Directive 2002/95/ EC (ROHS Directive) banned the use of lead and some flame retardants in electronic components as of July 2006. Our activities in the EU are also subject to the European Directive 2003/87/ EC establishing a scheme for greenhouse gas allowance trading, and to the applicable national implementing legislation. In addition, Regulation 1907/2006 of December 18, 2006 will require registration, evaluation, authorization and restriction of a large number of chemicals (REACH) starting June 1, 2007. The implementation of any such legislation could adversely affect our manufacturing costs or product sales by requiring us to acquire costly equipment, materials or greenhouse gas allowances, or to incur other significant expenses in adapting our manufacturing processes or waste and emission disposal processes. We are not in a position to quantify specific costs, in part because these costs are part of our business process. Furthermore, environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us, suspension of production or a cessation of operations. As with other companies engaged in similar activities, any failure by us to control the use of, or adequately restrict the discharge of, chemicals or hazardous substances could subject us to future liabilities. Any specific liabilities we identify as probable would be reflected in our balance sheet. To date, we have not identified any such specific liabilities. We therefore have not booked specific reserves for any specific environmental risks. See Item 4. Information on the Company Environmental Matters .

Loss of key employees could hurt our competitive position.

As is common in the semiconductor industry, success depends to a significant extent upon our key senior executives and research and development, engineering, marketing, sales, manufacturing, support and other personnel. Our success also depends upon our ability to continue to attract, retain and motivate qualified personnel. The competition for such employees is intense, and the loss of the services of any of these key personnel without adequate replacement or the inability to attract new qualified personnel could have a material adverse effect on us.

We operate in many jurisdictions with highly complex and varied tax regimes. Changes in tax rules or the outcome of tax assessments and audits could cause a material adverse effect on our results.

We operate in many jurisdictions with highly complex and varied tax regimes. Changes in tax rules or the outcome of tax assessments and audits could have a material adverse effect on our results in any particular quarter. For example, in 2006, we had an income tax benefit of \$20 million, as compared to an income tax expense of \$8 million in 2005. In 2006, we benefited from a favorable assessment of our tax assets and liabilities mainly due to a favorable outcome of a tax litigation in one of our jurisdictions. Our tax rate is variable and depends on changes in the level of operating profits within various local jurisdictions and on changes in the applicable taxation rates of these

jurisdictions, as well as changes in estimated tax provisions due to new events. We currently enjoy certain tax benefits in some countries, and these benefits may not be available in the future due to changes within the local jurisdictions. As a result, our effective tax rate could increase in the coming years.

We are subject to the possibility of loss contingencies arising out of tax claims and provisions for specifically identified income tax exposures. There can be no assurance that we will be successful in resolving

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such tax claims. Our failure to do so and/or the need to increase our provisions for such claims could have a material adverse effect on our financial position.

We have been required to prepare consolidated financial statements using both International Financial Reporting Standards (IFRS) beginning with our 2005 results in addition to our consolidated financial statements prepared pursuant to Generally Accepted Accounting Principles in the United States (U.S. GAAP) and dual reporting may impair the clarity of our financial reporting.

We are incorporated in the Netherlands and our shares are listed on Euronext Paris and on the Borsa Italiana, and, consequently, we are subject to an EU regulation issued on September 29, 2003 requiring us to report our results of operations and consolidated financial statements using IFRS (previously known as International Accounting Standards or IAS). Since our creation in 1987, we have always prepared our Consolidated Financial Statements under U.S. GAAP and intend to continue to do so, while at the same time complying with our reporting obligations under IFRS by preparing a complementary set of our 2006 accounts or as requested by local stock exchange authorities. Our decision to continue to apply U.S. GAAP in our financial reporting is designed to ensure the comparability of our results to those of our competitors and the continuity of our reporting, thereby providing our investors a clear understanding of our financial performance.

The obligation to report our Consolidated Financial Statements under IFRS requires us to prepare our results of operations using two different sets of reporting standards, U.S. GAAP and IFRS, which are currently not consistent. Such dual reporting could materially increase the complexity of our investor communications. The main potential areas of discrepancy concern capitalization and amortization of development expenses required under IFRS and the accounting for compound financial instruments. Our financial condition and results of operations reported in accordance with IFRS will differ from our financial condition and results of operations reported in accordance with U.S. GAAP, which could adversely affect the market price of our common shares.

Changes in the accounting treatment of stock options and other share-based compensation could adversely affect our results of operations.

We have in the past accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and as such generally recognize no compensation cost for employee stock options. In December 2004, the FASB issued revised FAS 123, *Share-Based Payment*, or FAS 123R, which requires companies to expense employee share-based compensation for financial reporting purposes. We adopted FAS 123R in the fourth quarter of 2005. See Item 5. Operating and Financial Review and Prospects and the Notes to the Consolidated Financial Statements. As a result, in the case of a distribution of new stock-based compensation, we are now required to value our employee stock-based compensation pursuant to a financial valuation model, and then amortize that value against our reported earnings over the vesting period in effect for those share-based compensation awards. This change in accounting treatment of employee stock and other forms of stock-based compensation could materially and adversely affect our results of operations, as the share-based compensation expense, beginning in the fourth quarter of 2005, is now charged directly against our earnings. This change could have an effect on our earnings per share, which could negatively impact our future stock price.

In addition, through the first half of 2005, we used stock options as a key component of employee compensation in order to align employees' interests with the interests of our shareholders, encourage employee retention, and provide competitive compensation packages. To the extent that FAS 123R or other new regulations make it more difficult or expensive to grant options or other forms of stock-based compensation to employees, we may incur increased compensation costs, change our equity compensation strategy, or find it difficult to attract, retain, and motivate employees. Any of these results could materially and adversely affect our business and operating results.

If our internal control over financial reporting fail to meet the requirements of Section 404 of the Sarbanes-Oxley Act, it may have a materially adverse effect on our stock price.

The SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules that require us to include a management report assessing the effectiveness of our internal control over financial reporting in our annual report on Form 20-F. In addition, we must also include an attestation by our independent registered public accounting firm regarding the adequacy of management's assessment and the effectiveness of our internal control over financial

reporting. We have successfully completed our Section 404 assessment and received the auditors' attestation as of December 31, 2006. However, in the future, if we fail to complete a favorable assessment from our management or to obtain our auditors' attestation, we may be subject to regulatory sanctions or may suffer a loss of investor confidence in the reliability of our financial statements, which could lead to an adverse effect on our stock price.

Table of Contents***Reduction in the amount of public funding available to us, changes in existing public funding programs or demands for repayment may increase our costs and impact our results of operations.***

Like many other manufacturers operating in Europe, we benefit from governmental funding for research and development expenses and industrialization costs (which include some of the costs incurred to bring prototype products to the production stage), as well as from incentive programs for the economic development of underdeveloped regions. Public funding may also be characterized by grants and/or low-interest financing for capital investment and/or tax credit investments. See Item 4. Information on the Company Public Funding . We have entered into public funding agreements in France and Italy, which set forth the parameters for state support to us under selected programs. These funding agreements may require compliance with EU regulations and approval by EU authorities.

We rely on receiving funds on a timely basis pursuant to the terms of the funding agreements. However, funding of programs in France and Italy is subject to annual appropriation of available resources and compatibility with the fiscal provisions of their annual budgets, which we do not control, as well as to our continuing compliance with all eligibility requirements. If we are unable to receive anticipated funding on a timely basis, or if existing government-funded programs were curtailed or discontinued, or if we were unable to fulfill our eligibility requirements, this could have a material adverse effect on our business, operating results and financial condition. There is no assurance that any alternative funding would be available, or that, if available, it could be provided in sufficient amounts or on similar terms.

The application for and implementation of such grants often involves compliance with extensive regulatory requirements including, in the case of subsidies to be granted within the EU, notification to the European Commission by the member state making the contemplated grant prior to disbursement. In particular, compliance with project-related ceilings on aggregate subsidies defined under EU law often involves highly complex economic evaluations. Furthermore, public funding arrangements are generally subject to annual and project-by-project reviews and approvals. If we fail to meet applicable formal or other requirements, we may not be able to receive the relevant subsidies or may be obliged to repay them which could have a material adverse effect on our results of operations.

On April 9, 2002, the EU approved a grant to us by the Italian Government of \$542.3 million (Decision N844/2001), representing approximately 26.25% of the total cost (estimated at \$2,066 million) (the M6 Grant) for the building, facilitization and equipment of a new 300-mm manufacturing facility in Catania M6 capable of producing approximately 5,000 wafers per week in 2006 for NOR and other nonvolatile memory products (the M6 Plant). The construction of the M6 Plant has not proceeded as planned. In 2006, the Italian Government informed the EU Commission about a proposed modification to the conditions for the M6 Grant, as authorized on April 9, 2002. In a decision on December 6, 2006 sent to the Italian Foreign Minister, the EU Commission, according to the proposal made by the Italian government, accepted to modify the conditions for the M6 Grant.

In particular, the EU Commission accepted the proposal of the Italian government to provide for an extension of the authorized time period for the completion of the planned investment and to allocate, out of the \$542.3 million grants originally authorized, \$446 million for the completion of the M6 Plant if we made a further investment of \$1,700 million between January 1, 2006 through the end of 2009. The \$446 million M6 Grant is conditional upon the conclusion of a Contratto di Programma providing, *inter alia*, for (i) the creation of a minimum number of new jobs, (ii) the fixed assets remaining at least five years after the completion of the M6 Plant, (iii) at least 31.25% of the total of \$1,700 million investment for the M6 Plant being either in the form of equity or loan, (iv) an annual report on work progress being submitted to the Italian authorities and the EU Commission, and (v) a general verification of the consistency of the project. For the period prior to December 31, 2006, the Commission, upon the proposal of the Italian government, considered that we would have been entitled to the remaining \$96 million grant (out of the total \$542.3 million originally granted) in the form of a tax credit if we had made a total cumulated investment of \$366 million as of such date. As of December 31, 2006, we have invested a cumulative amount of \$298 million instead of \$366 million and recorded a cumulative amount of tax credit of \$78 million out of the \$96 million to which we could have been entitled.

There is no assurance that the *Contratto di Programma* will be concluded at acceptable conditions to both the Italian authorities and us, and that, if concluded, such contract will be approved by the EU Commission if the stated

conditions are not consistent with prior decisions by the EU Commission concerning such grants. Failure to receive the grants as anticipated may adversely impair our expected results of operations linked to the equipment and operation of the M6 Plant.

Table of Contents***The interests of our controlling shareholders, which are in turn controlled respectively by the French and Italian governments, may conflict with investors' interests.***

We have been informed that as of December 31, 2006, STMicroelectronics Holding II B.V. (ST Holding II), a wholly-owned subsidiary of STMicroelectronics Holding N.V. (ST Holding), owned 250,704,754 shares, or approximately 27.5%, of our issued common shares. ST Holding is therefore effectively in a position to control actions that require shareholder approval, including corporate actions, the election of our Supervisory Board and our Managing Board and the issuance of new shares or other securities.

We have also been informed that the shareholders' agreement among ST Holding's shareholders (the STH Shareholders' Agreement), to which we are not a party, governs relations between our current indirect shareholders Areva Group, Cassa Depositi e Prestiti S.p.A. (CDP) and Finmeccanica S.p.A. (Finmeccanica), each of which is ultimately controlled by the French or Italian government, see Item 7. Major Shareholders and Related-Party Transactions - Major Shareholders. The STH Shareholders' Agreement includes provisions requiring the unanimous approval by shareholders of ST Holding before ST Holding can make any decision with respect to certain actions to be taken by us. Furthermore, as permitted by our Articles of Association, the Supervisory Board has specified selected actions by the Managing Board that require the approval of the Supervisory Board. See Item 7. Major Shareholders and Related-Party Transactions - Major Shareholders. These requirements for the prior approval of various actions to be taken by us and our subsidiaries may give rise to a conflict of interest between our interests and investors' interests, on the one hand, and the interests of the individual shareholders approving such actions, on the other, and may affect the ability of our Managing Board to respond as may be necessary in the rapidly changing environment of the semiconductor industry. Furthermore, our ability to issue new shares or other securities may be limited by the existing shareholders' desire to maintain their proportionate shareholding at a certain minimum level. Such approval process is, however, subject to the provisions of Dutch law requiring members of our Supervisory Board to act independently in supervising our management and applicable Dutch and non-Dutch corporate governance standards.

Our shareholder structure and our preference shares may deter a change of control.

On November 27, 2006, our Supervisory Board decided to authorize us to enter into an option agreement with an independent foundation, Stichting Continuïteit ST (the Stichting), and to terminate a substantially similar option agreement dated May 31, 1999, as amended, between us and ST Holding II. Our Managing Board and our Supervisory Board, along with the board of the Stichting, have declared that they are jointly of the opinion that the Stichting is independent of our Company and our major shareholders. Our Supervisory Board approved the new option agreement to reflect changes in Dutch legal requirements, not in response to any hostile takeover attempt. On February 7, 2007, the May 31, 1999 option agreement, as amended, was terminated by mutual consent by ST Holding II and us and the new option agreement we concluded with the Stichting became effective on the same date. The new option agreement provides for the issuance of up to a maximum of 540,000,000 preference shares, the same number as the May 31, 1999 option agreement, as amended. The Stichting would have the option, which it shall exercise in its sole discretion, to take up the preference shares. The preference shares would be issuable in the event of actions considered hostile by our Managing Board and Supervisory Board, such as a creeping acquisition or an unsolicited offer for our common shares, which are unsupported by our Managing Board and Supervisory Board and which the board of the Stichting determines would be contrary to the interests of our Company, our shareholders and our other stakeholders. If the Stichting exercises its call option and acquires preference shares, it must pay at least 25% of the par value of such preference shares. The preference shares may remain outstanding for no longer than two years.

No preference shares have been issued to date. The effect of the preference shares may be to deter potential acquirers from effecting an unsolicited acquisition resulting in a change of control or otherwise taking actions considered hostile by our Managing Board and Supervisory Board. In addition, any issuance of additional capital within the limits of our authorized share capital, as approved by our shareholders, is subject to the requirements of our Articles of Association, see Item 10. Additional Information - Memorandum and Articles of Association - Share Capital as of December 31, 2006 - Issuance of Shares, Preemption Rights and Preference Shares (Article 4).

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Our direct or indirect shareholders may sell our existing common shares or issue financial instruments exchangeable into our common shares at any time while at the same time seeking to retain their rights regarding our preference shares. In addition, substantial sales by us of new common shares or convertible bonds could cause our common share price to drop significantly.

The STH Shareholders Agreement, to which we are not a party, permits our respective French and Italian indirect shareholders to cause ST Holding to dispose of its stake in us at its sole discretion at any time from their current level, and to reduce the current level of their respective indirect interests in our common shares to 9.5%. The details of the STH Shareholders Agreement as declared by ST Holding II in its Schedule 13G/ A filing dated February 13, 2007, are further explained in Item 7. Major Shareholders and Related-Party Transactions Major Shareholders . Disposals of our shares by the parties to the STH Shareholders Agreement can be made by way of the issuance of financial instruments exchangeable for our shares, equity swaps, structured finance transactions or sales of our shares. An announcement with respect to one or more of such dispositions could be made at any time without our advance knowledge.

In addition, Finmeccanica Finance S.A. (Finmeccanica Finance), a subsidiary of Finmeccanica, has issued 501 million aggregate principal amount of exchangeable notes, exchangeable into up to 20 million of our existing common shares due 2010 (the Finmeccanica Notes). The Finmeccanica Notes have been exchangeable at the option of the holder into our existing common shares since January 2, 2004. In September 2005, France Telecom caused the sale of approximately 26 million of our common shares pursuant to the terms of a convertible bond issued by France Telecom. In December 2005, Finmeccanica caused the sale of approximately 1.5 million of our common shares.

Further sales of our common shares or issue of bonds exchangeable into our common shares or any announcements concerning a potential sale by ST Holding, Areva, CDP or Finmeccanica, could materially impact the market price of our common shares. The timing and size of any future share or exchangeable bond offering by ST Holding, Areva, CDP or Finmeccanica would depend upon market conditions as well as a variety of factors.

Because we are a Dutch company subject to the corporate law of the Netherlands, U.S. investors might have more difficulty protecting their interests in a court of law or otherwise than if we were a U.S. company.

Our corporate affairs are governed by our Articles of Association and by the laws governing corporations incorporated in the Netherlands. The corporate affairs of each of our consolidated subsidiaries are governed by the articles of association and by the laws governing such corporations in the jurisdiction in which such consolidated subsidiary is incorporated. The rights of the investors and the responsibilities of members of our Supervisory Board and Managing Board under Dutch law are not as clearly established as under the rules of some U.S. jurisdictions. Therefore, U.S. investors may have more difficulty in protecting their interests in the face of actions by our management, members of our Supervisory Board or our controlling shareholders than U.S. investors would have if we were incorporated in the United States.

Our executive offices and a substantial portion of our assets are located outside the United States. In addition, ST Holding II and most members of our Managing and Supervisory Boards are residents of jurisdictions other than the United States and Canada. As a result, it may be difficult or impossible for shareholders to effect service within the United States or Canada upon us, ST Holding II, or members of our Managing or Supervisory Boards. It may also be difficult or impossible for shareholders to enforce outside the United States or Canada judgments obtained against such persons in U.S. or Canadian courts, or to enforce in U.S. or Canadian courts judgments obtained against such persons in courts in jurisdictions outside the United States or Canada. This could be true in any legal action, including actions predicated upon the civil liability provisions of U.S. securities laws. In addition, it may be difficult or impossible for shareholders to enforce, in original actions brought in courts in jurisdictions located outside the United States, rights predicated upon U.S. securities laws.

We have been advised by our Dutch counsel, De Brauw Blackstone Westbroek N.V., that the United States and the Netherlands do not currently have a treaty providing for reciprocal recognition and enforcement of judgments (other than arbitration awards) in civil and commercial matters. As a consequence, a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not predicated solely upon the federal securities laws of the United States, will not be enforceable in the Netherlands. However, if the party in whose favor such final judgment is rendered brings a new suit in a competent court in the Netherlands, such party may submit to the Netherlands court the final judgment that has been rendered in the United States. If the

Netherlands court finds that the jurisdiction of the federal or state court in the United States has been based on grounds that are internationally acceptable and that proper legal procedures have been observed, the court in the Netherlands would, under current practice, give binding effect to

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the final judgment that has been rendered in the United States unless such judgment contravenes the Netherlands public policy.

Removal of our common shares from the CAC 40 on Euronext Paris, the S&P/ MIB on the Borsa Italiana or the Philadelphia Stock Exchange Semiconductor Sector Index could cause the market price of our common shares to drop significantly.

Our common shares have been included in the CAC 40 index on Euronext Paris since November 12, 1997; the S&P/ MIB on the Borsa Italiana, or Italian Stock Exchange since March 18, 2002; and the Philadelphia Stock Exchange Semiconductor Index (SOX) since June 23, 2003. However, our common shares could be removed from the CAC 40, the S&P/ MIB or the SOX at any time, and any such removal or announcement thereof could cause the market price of our common shares to drop significantly.

Table of Contents**Item 4. Information on the Company****History and Development of the Company**

STMicroelectronics N.V. was formed and incorporated in 1987 and resulted from the combination of the semiconductor business of SGS Microelettronica (then owned by Società Finanziaria Telefonica (S.T.E.T.), an Italian corporation) and the non-military business of Thomson Semiconducteurs (then owned by the former Thomson-CSF, now Thales, a French corporation). Until 1998, we operated as SGS-Thomson Microelectronics N.V. Our length of life is indefinite. We are organized under the laws of the Netherlands. We have our corporate legal seat in Amsterdam and our head offices at WTC Schiphol Airport, Schiphol Boulevard 265, 1118 BH Schiphol Airport, Amsterdam, the Netherlands. Our telephone number there is +31-20-654-3210. Our headquarters and operational offices are located at 39 Chemin du Champ des Filles, 1228 Plan-Les-Ouates, Geneva, Switzerland. Our main telephone number there is +41-22-929-2929. Our agent for service of process in the United States related to our registration under the U.S. Securities Exchange Act of 1934, as amended, is STMicroelectronics, Inc., 1310 Electronics Drive, Carrollton, Texas, 75006-5039 and the main telephone number there is +1-972-466-6000. Our operations are also conducted through our various subsidiaries, which are organized and operated according to the laws of their country of incorporation, and consolidated by STMicroelectronics N.V.

We completed our initial public offering in December 1994 with simultaneous listings on Euronext Paris and the New York Stock Exchange. In 1998, we listed our shares on the Borsa Italiana.

Business Overview

We are a global independent semiconductor company that designs, develops, manufactures and markets a broad range of semiconductor products used in a wide variety of microelectronic applications, including automotive products, computer peripherals, telecommunications systems, consumer products, industrial automation and control systems. According to provisional industry data published by iSuppli, we have been ranked the world's fifth largest semiconductor company based on forecasted 2006 total market sales and we held leading positions in sales of Analog Products, Application Specific Integrated Circuits (or ASICs) and Application Specific Standard Products (or ASSPs). Based on provisional 2006 results published by iSuppli, we believe we were number one in industrial products, number two in analog products and number three in wireless, automotive electronics and NOR Flash. Based on industry results, we also believe we ranked as a leading supplier of semiconductors in 2006 for set-top boxes, Smartcards and power management devices. Furthermore, based on our relationship with Hewlett-Packard, which has a leading position in the printhead market, we believe that we are a leading supplier of integrated circuits for printheads. Our major customers include Alcatel-Lucent, Bosch, Cisco, Conti, Delphi, Delta, Denso, Ericsson, Hewlett-Packard, LG Electronics, Marelli, Maxtor, Motorola, Nokia, Philips, Pioneer, Samsung, Seagate, Siemens, Thomson, Vestel, Visteon and Western Digital. We also sell our products through global distributors and retailers, including Arrow Electronics, Avnet, BSI Group, Wintech and Yosun.

The semiconductor industry has historically been a cyclical one and we have responded through emphasizing balance in our product portfolio, in the applications we serve, and in the regional markets we address. Consequently, from 1994 through 2006, our revenues grew at a compounded annual growth rate of 11.6% compared to 7.7% for the industry as a whole.

We offer a broad and diversified product portfolio and develop products for a wide range of market applications to reduce our dependence on any single product, application or end market. Within our diversified portfolio, we have focused on developing products that leverage our technological strengths in creating customized, system-level solutions with high-growth digital and mixed-signal content. Our product families include differentiated application-specific products (which we define as being our dedicated analog, mixed-signal and digital ASIC and ASSP offerings and semicustom devices), power microcontrollers and discrete products and nonvolatile memory and Smartcards. Application Specific Products, which are generally less vulnerable to market cycles than standard commodity products, accounted for approximately 55% of our net revenues in 2006. Memory Product sales accounted for approximately 22% of our net revenues in 2006, while sales of Micro, Power and Analog products accounted for approximately 23% of our net revenues in 2006.

Our products are manufactured and designed using a broad range of manufacturing processes and proprietary design methods. We use all of the prevalent function-oriented process technologies, including complementary metal

oxide semiconductor (CMOS), bipolar and nonvolatile memory technologies. In addition, by combining basic processes, we have developed advanced systems-oriented technologies that enable us to produce differentiated and application-specific products, including bipolar CMOS technologies (BiCMOS) for mixed-signal applications, and diffused metal oxide semiconductor (DMOS) technology and Bipolar, CMOS and DMOS (BCD technologies) for intelligent power applications and embedded memory

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technologies. This broad technology portfolio, a cornerstone of our strategy for many years, enables us to meet the increasing demand for System-on-Chip (SoC) solutions. Complementing this depth and diversity of process and design technology is our broad intellectual property portfolio that we also use to enter into important patent cross-licensing agreements with other major semiconductor companies.

Effective January 1, 2005, we realigned our product groups to increase market focus and realize the full potential of our products, technologies and sales and marketing channels. Since this date and until the end of 2006, we report our sales and operating income in three product group segments:

the Application Specific Product Group (ASG) segment, comprised of three product lines our Home, Personal and Communication Products (HPC), our Computer Peripherals Products (CPG) and our Automotive Products (APG). Our HPC Sector is comprised of the telecommunications, audio and digital consumer groups. Our CPG products cover computer peripherals products, specifically disk drives and printers, and our APG products comprised of all of our major complex products related to automotive applications;

the Memory Products Group (MPG) segment, comprised of our memories and Smartcard businesses; and

the Micro, Power, Analog Product Group (MPA) segment, comprised of discrete and standard products plus standard microcontroller and industrial devices (including the programmable systems memories (PSM) division); this segment was previously known as Micro, Linear and Discrete Product Group, but no change has occurred in the segment s perimeter or organization.

Effective January 1, 2007, to meet the evolving requirements of the market together with the pursuit of a strategic repositioning in Flash memory, we have reorganized our product segment groups into the Application Specific Product Groups, the Industrial and Multisegment Sector and the Flash Memories Group. We will begin reporting sales and segment financial information using this alignment beginning in the first quarter of 2007.

Our principal investment and resource allocation decisions in the semiconductor business area are for expenditures on research and development and capital investments in front-end and back-end manufacturing facilities. All our product segments share common research and development for process technology and manufacturing capacity for most of their products. However, beginning January 1, 2007, the stand-alone Flash Memories Group (FMG), incorporates all the Flash memory operations (both NOR and NAND), including Technology R&D, all product related activities, front-end and back-end manufacturing, marketing and sales worldwide. Keeping the same overall perimeter, our Application Specific Groups (ASG) will now be comprised of the newly created Mobile, Multimedia & Communications Group (MMC) and the Home Entertainment & Displays Group (HED) as well as the existing Automotive Product Group (APG) and Computer Peripherals Group (CPG). The former MPA segment plus non-Flash memory products (formerly under MPG) and Micro-Electro-Mechanical Systems (MEMS) activity have been combined to form a new sector, Industrial and Multisegment Sector (IMS).

In the past two years, we have pursued various initiatives to reshape our company by (i) reorganizing our management team and setting up an executive committee, (ii) increasing our research and development effectiveness through a program focusing on our key initiatives, improved project control and redeployment of certain resources with the aim to improve time-to-market for both technologies and products, (iii) promoting sales expansion for mass market applications and new major key accounts with a special focus on the Chinese and Japanese markets with a view to increased overall efficiencies, (iv) improving our manufacturing competitiveness through the restructuring of our 150-mm wafer production capacity, (v) launching and implementing various cost-reduction initiatives through procurement savings, improved asset management, general and administration centralization and headcount restructuring, and (vi) establishing a less capital-intensive business model.

Table of Contents**Results of Operations**

The tables below set forth information on our net revenues by product group segment and by geographic region:

	Year Ended December 31,		
	2006	2005	2004
	(In millions, except percentages)		
Net Revenues by Product Segment			
Application Specific Product Group Segment (ASG)	\$ 5,396	\$ 4,991	\$ 4,902
Memory Products Group Segment (MPG)	2,137	1,948	1,887
Micro, Power, Analog Product Group Segment (MPA)	2,243	1,882	1,902
Others(1)	78	61	69
Total	\$ 9,854	\$ 8,882	\$ 8,760
Net Revenues by Location of Order Shipment(2)			
Europe(3)	\$ 3,073	\$ 2,789	\$ 2,827
North America(6)	1,232	1,281	1,360
Asia Pacific(4)	2,084	1,860	1,852
Greater China(4)	2,552	2,203	1,859
Japan	400	307	403
Emerging Markets(3)(5)(6)	513	442	459
Total	\$ 9,854	\$ 8,882	\$ 8,760
Net Revenues by Product Segment			
Application Specific Product Group Segment (ASG)	54.7%	56.2%	56.0%
Memory Products Group Segment (MPG)	21.7	21.9	21.5
Micro, Power, Analog Product Group Segment (MPA)	22.8	21.2	21.7
Others(1)	0.8	0.7	0.8
Total	100.0%	100.0%	100.0%
Net Revenues by Location of Order Shipment(2)			
Europe(3)	31.2%	31.4%	32.3%
North America(6)	12.5	14.4	15.5
Asia Pacific(4)	21.1	20.9	21.2
Greater China(4)	25.9	24.8	21.2
Japan	4.1	3.5	4.6
Emerging Markets(3)(5)(6)	5.2	5.0	5.2
Total	100.0%	100.0%	100.0%

(1) Includes revenues from sales of subsystems and other revenues not allocated to product segments.

- (2) Net revenues by location of order shipment are classified by location of customer invoiced. For example, products ordered by companies to be invoiced to Asia Pacific affiliates are classified as Asia Pacific revenues.
- (3) Since January 1, 2005, the region Europe includes the former East European countries that joined the EU in 2004. These countries were part of the Emerging Markets region in the previous periods. Net revenues for Europe and Emerging Markets for prior periods were restated to include such countries in the Europe region for such periods.
- (4) As of January 1, 2006, we created a new region, Greater China to focus exclusively on our operations in China, Hong Kong and Taiwan. Net revenues for Asia Pacific for prior periods were restated according to the new perimeter.
- (5) Emerging Markets in 2005 and 2006 included markets such as India, Latin America (excluding Mexico), the Middle East and Africa, Europe (non-EU and non-EFTA) and Russia.
- (6) As of July 2, 2006, the region North America includes Mexico which was part of Emerging Markets in prior periods. Amounts have been reclassified to reflect this change.

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Strategy

The semiconductor industry is undergoing several significant structural changes characterized by:

the changing long-term structural growth of the overall market for semiconductor products, which has moved from double-digit growth to single-digit average growth over the last several years;

the strong development of new emerging applications in areas such as wireless communications, solid-state storage, digital TV and video products and games;

the increasing importance of the Asia Pacific region and emerging countries, particularly China, which represents the fastest growing regional market;

the importance of convergence between wireless, consumer and computer applications, which drives customer demand to seek new system-level, turnkey solutions from semiconductor suppliers;

the evolution of the customer base from original equipment manufacturers (OEM) to a mix of OEM, electronic manufacturing service providers (EMS) and original design manufacturers (ODM);

the expansion of available manufacturing capacity through third-party providers; and

the increased participation in the semiconductor industry of private equity firms, exemplified by the takeovers in 2006 of two of the top ten semiconductor companies, which may lead to strategic repositionings of those companies and reorganization amongst industry players.

Our strategy within this challenging environment is designed to focus on the following complementary key elements:

Broad, balanced market exposure. We offer a diversified product portfolio and develop products for a wide range of market applications using a variety of technologies, thereby reducing our dependence on any single product, application or end market. Within our diversified portfolio, we have focused on developing products that leverage our technological strengths in creating customized, system-level solutions for high-growth digital and mixed-signal applications. We target five key markets comprised of: (i) communications, including wireless connectivity, mobile phone imaging, portable multimedia and infrastructure; (ii) computer peripherals, including data storage, printers, monitors, displays and optical mice; (iii) digital consumer, including set-top boxes, DVDs, digital TVs, digital cameras and digital audio; (iv) automotive, including engine, body and safety, car radio, car multimedia and telematics; and (v) industrial and multisegment products, including power supplies, and motor-control, lighting, metering, banking and Smartcard.