

# Dialog Semiconductor Annual Report 2003



Innovative Silicon for a Mobile World



**Dialog**  
Semiconductor

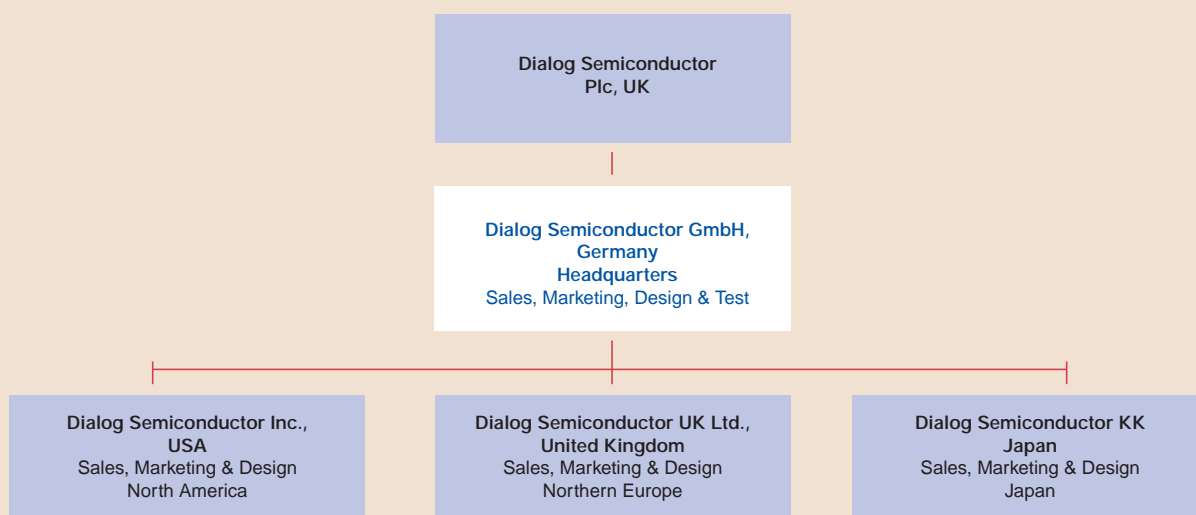
# Dialog Semiconductor Plc – Five-Year Financial Summary

## Selected Financial Data

(in thousands of €, except per share, equity ratio and employee data)	2003	2002	2001	2000	1999
<b>Earnings data</b>					
Revenues	92,893	77,104	100,519	214,459	87,246
Research and development	(30,590)	(34,530)	(31,256)	(22,898)	(11,108)
Operating profit (loss)	(13,224)	(27,406)	(24,136)	38,387	11,566
Net loss	(20,420)	(10,208)	(41,386)	26,650	6,680
Cash flow from operations <sup>1)</sup>	7,588	(7,596)	15,139	18,072	(907)
<b>Balance sheet data</b>					
Cash and cash equivalents	8,109	31,005	32,626	29,879	11,257
Shareholders' equity	126,843	147,495	158,092	199,287	68,611
Equity ratio in %	90.3	88.8	88.3	80.5	75.5
Total assets	140,471	166,073	179,062	247,572	90,864
Capital expenditures	5,901	3,872	3,157	39,024	14,487
<b>Share data</b>					
Basic earnings (loss) per share	(0.46)	(0.23)	(0.94)	0.62	0.16
Number of shares in thousands (period end)	44,069	44,069	44,069	44,069	42,069
<b>Other data</b>					
Employees (at December 31)	273	284	287	268	142

<sup>1)</sup>In 2000 excluding advance payments to secure silicon capacity of € 23,201.

## Overview of the legal Group structure



## Unaudited Quarterly Financial Information

2003	Q1	Q2	Q3	Q4	Total
Revenues	21,015	21,086	23,247	27,545	92,893
<b>Gross margin</b>	<b>6,221</b>	<b>6,472</b>	<b>8,008</b>	<b>9,818</b>	<b>30,519</b>
Selling, general and administrative expenses	(2,335)	(2,344)	(2,347)	(2,215)	(9,241)
Research and development	(8,767)	(7,455)	(7,296)	(7,072)	(30,590)
Amortization of intangible assets	(551)	(553)	(485)	(484)	(2,073)
Restructuring and related impairment charges	(1,465)	(315)	(59)	–	(1,839)
<b>Operating profit (loss)</b>	<b>(6,897)</b>	<b>(4,195)</b>	<b>(2,179)</b>	<b>47</b>	<b>(13,224)</b>
Financial income (expense), net	2	205	71	25	303
Recovery of investment	166	–	149	–	315
<b>Result before income taxes</b>	<b>(6,729)</b>	<b>(3,990)</b>	<b>(1,959)</b>	<b>72</b>	<b>(12,606)</b>
Income taxes	1,864	1,352	457	(11,487)	(7,814)
<b>Net income (loss)</b>	<b>(4,865)</b>	<b>(2,638)</b>	<b>(1,502)</b>	<b>(11,415)</b>	<b>(20,420)</b>
Basic earnings (loss) per share	(0.11)	(0.06)	(0.03)	(0.26)	(0.46)

2002	Q1	Q2	Q3	Q4	Total
Revenues	19,063	17,051	17,903	23,087	77,104
<b>Gross margin</b>	<b>5,516</b>	<b>4,648</b>	<b>4,993</b>	<b>4,538</b>	<b>19,695</b>
Selling, general and administrative expenses	(2,297)	(2,603)	(2,696)	(3,000)	(10,596)
Research and development	(7,996)	(8,617)	(8,574)	(9,343)	(34,530)
Amortization of goodwill and intangible assets	(447)	(444)	(540)	(544)	(1,975)
<b>Operating loss</b>	<b>(5,224)</b>	<b>(7,016)</b>	<b>(6,817)</b>	<b>(8,349)</b>	<b>(27,406)</b>
Financial income (expense), net	362	(1,422)	491	(228)	(797)
Recovery of investment	6,457	755	2,675	2,082	11,969
<b>Result before income taxes</b>	<b>1,595</b>	<b>(7,683)</b>	<b>(3,651)</b>	<b>(6,495)</b>	<b>(16,234)</b>
Income taxes	(588)	2,773	1,299	2,542	6,026
<b>Net income (loss)</b>	<b>1,077</b>	<b>(4,910)</b>	<b>(2,352)</b>	<b>(3,953)</b>	<b>(10,208)</b>
Basic earnings (loss) per share	0.02	(0.11)	(0.05)	(0.09)	(0.23)

2001	Q1	Q2	Q3	Q4	Total
Revenues	30,611	25,490	20,662	23,756	100,519
<b>Gross margin</b>	<b>10,439</b>	<b>(2,979)</b>	<b>5,939</b>	<b>6,546</b>	<b>19,945</b>
Selling, general and administrative expenses	(2,429)	(2,722)	(2,198)	(2,274)	(9,623)
Research and development	(6,630)	(8,421)	(7,830)	(8,375)	(31,256)
Amortization of goodwill and intangible assets	(790)	(813)	(817)	(782)	(3,202)
<b>Operating profit (loss)</b>	<b>590</b>	<b>(14,935)</b>	<b>(4,906)</b>	<b>(4,885)</b>	<b>(24,136)</b>
Financial income (expense), net	2,377	1,530	(2,481)	1,185	2,611
Recovery of investment	–	–	–	(42,405)	(42,405)
<b>Result before income taxes</b>	<b>2,967</b>	<b>(13,405)</b>	<b>(7,387)</b>	<b>(46,105)</b>	<b>(63,930)</b>
Income taxes	(1,225)	4,675	2,554	16,540	22,544
<b>Net income (loss)</b>	<b>1,742</b>	<b>(8,730)</b>	<b>(4,833)</b>	<b>(29,565)</b>	<b>(41,386)</b>
Basic earnings (loss) per share	0.04	(0.20)	(0.11)	(0.67)	(0.94)

# Semiconductor solutions for a mobile world

The world is becoming increasingly mobile. For both work and leisure, there's a whole new generation of sophisticated electronics systems in mobile phones and cars that enable people to achieve the ultimate in work-life balance. Mobile phones are now 'smart' and also let you take high quality pictures. In cars, the comfort and safety systems are becoming highly intelligent and passenger-friendly. Dialog Semiconductor is an established developer and supplier of innovative, mixed signal semiconductor solutions that enhance the capabilities of these electronics systems. We develop a range of chip and system-level solutions for managing power consumption, enhancing audio performance, capturing images and ensuring excellent colour displays in these products.

Our standard products and custom solutions meet the demanding needs of:



## Wireless communications

The growing sophistication of mobile phones and personal organizers results in an increased demand for power from the battery. Our power management technology significantly improves talk and standby times, and with integrated audio on our chips we also enable CD-quality music playback.



## Automotive and industrial

From engine management and comfort electronics systems in cars, to 'smart' industrial lighting control systems, both exploit our expertise in developing highly integrated high and low voltage systems on a single chip.



## Imaging and display

Real-time, high-performance, high-resolution image capture is becoming vital in mobile and automotive applications. Our range of image sensors, camera modules and colour display drivers enable the ultimate consumer experience in wireless handsets, and the highest accuracy in automotive systems.

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# Shareholder Information

## Letter to our Shareholders

Dear Shareholders,



2003 ended positively for Dialog Semiconductor, with revenues increasing by 20 percent to €93 million compared to 2002. We believe that we are again on the path to profitability, as operating profit for Q 4 2003 was positive to take us past breakeven for the quarter. The improved performance and prospects resulted in a significant increase in Dialog's share price in 2003.

We attribute the growth in revenues to the combined forces of a market recovery and the company's transition to giving customers greater flexibility by offering both standard products and custom silicon solutions.

I am pleased to report that the transition is proving successful, since it is firmly grounded in markets and applications we have spent years in developing – wireless communications, automotive electronics and industrial systems. In addition, we continue to develop new products and partnerships that exploit our core competences and key strengths in engineering and research and development.

These strengths are based around Dialog's leadership in mixed signal design in CMOS (complementary metal oxide semiconductor) manufacturing technology, and power management performance. In order to provide our customers with the competitive edge needed in these areas, our research and development programs continually extend the boundaries of high performance analog circuit design, high voltage capability in low power processes and system on chip (SoC) integration.

In 2003 this resulted in new standard products – the DA9010 and DA9031 – which provide highly integrated power management and audio processing on a single chip. These chips utilize Dialog Semiconductor's patented Smart Mirror™ technology to significantly reduce the current consumption in a portable device without having to design complex power-saving circuits. Optimum power consumption and excellent audio capability are essential at a time when we are seeing a high level of convergence in GSM/GPRS cellular phone handsets, personal digital assistants (PDAs), and digital camera functionality.

The latest product area for Dialog Semiconductor is our family of color liquid crystal display (LCD) drivers for wireless handsets. This is not a random new direction, but one which is in line with our overall strategy and experience. We partnered with leading display technology specialists to license their technology, and then applied our expertise to develop components for cellular phone handsets – a market we understand very well.

Partnerships with companies at all levels of business are extremely important for success in a market dominated by major

players. In addition to our long-term partnerships with key blue-chip customers, in 2003, we continued to develop products based on our excellent relationships with major players such as Intel Corporation, Bosch and Optrex, while also maintaining strong links with the world's leading manufacturing and assembly partners. The launch of our integrated power management and audio products is a typical example of the result of these relationships. In addition, we work diligently to ensure we meet our customer's highest quality standards. In the environmental management system area, this is demonstrated by our recent certification as a 'Sony Green Partner' by Sony Corporation.

Revenue growth for Dialog Semiconductor came from the overall recovery in the cellular phone handset market, and also from growth in deliveries to customers in Asia. A key contributor to this growth was shipments of devices for wireless products. We have also seen significant new opportunities for Dialog in the automotive and industrial markets. In the latter, we developed a single-chip electronic 'ballast' circuit for fluorescent lamps, again taking advantage of our expertise in high-voltage circuits, CMOS technology, and system integration. This technology results in more efficient circuits in power supplies in many applications, such as mobile computing, lamps and communication systems.

Market analysts are indicating further growth in cellular phone handsets, and PDAs. Since each requires some form of wireless communication, audio, digital photo or video capability, we see a

tremendous opportunity for Dialog Semiconductor in this market, with both standard products and customer specific chip solutions.

In summary, we have continued to build upon our core design, manufacturing expertise and technology base; this means maintaining our focus on our core competences whilst continuing our transition to a provider of both ASICs (application specific integrated circuits) and ASSPs (application specific standard products). We have made progress in new product areas related to the markets we know best. We have also seen growth after a period of downturn in our main market. Based on our strategy of continuing to exploit our technology base to deliver silicon solutions that our customers need, I am confident for the year ahead.

We would not be in such a good position to take advantage of the market recovery without the dedicated hard work of our employees and the ongoing support of our partners, customers and stakeholders. So, once again, I would like to express our thanks to all, and I look forward to maintaining the momentum we have achieved through 2004.

Kirchheim/Nabern, February 2004.



Roland Pudelko  
CEO & President

## Management



**Roland  
Pudelko**

### **Chief Executive Officer and President (51)**

With Dialog Semiconductor since 1989 and served as Executive Director, CEO and President since March 1998. With a diploma in communication technologies, he has over 20 years experience in management, design and engineering in electronics within the Daimler-Benz Group, and TEMIC. He is also Managing Director of Dialog Semiconductor GmbH and other subsidiaries of Dialog Semiconductor Plc.



**Peter  
Hall**

### **Vice-President, Quality and Technical Support (52)**

With Dialog Semiconductor since 1987 and responsible for technical support, IT and quality. Previous management and engineering positions were at STC Semiconductors and MEM in Switzerland. He graduated in electrical and electronic engineering in 1974, obtained an MSc in digital techniques in 1977, and an MBA in technology management during 2003.



**Gary  
Duncan**

### **Vice-President, Engineering – Imaging (48)**

With Dialog Semiconductor since 1987 and is responsible for the design and development of imaging products. Prior to Dialog, he held various senior engineering and management positions at Plessey and ES2. He obtained a Higher National Certificate in electronics and mathematics from Plymouth Polytechnic in the UK and is a chartered engineer.



**Erwin  
Hopf**

### **Vice President, Operations (49)**

With Dialog Semiconductor since 2002, and is responsible for operations. From 1980 until 2002 he held various process engineering as well as research and development and production management positions at Siemens Components and Infineon Technologies. He received his diploma in physics in 1980 from the Technical University of Darmstadt.





**Yoshihiko  
Kido**

**Vice President, Japan (51)**

With Dialog Semiconductor since 2001, and is responsible for Dialog's Japanese operation. He was previously a consultant at Overseas Affiliates Pty. Ltd., and held management positions at General Electric, Act Japan, Seagate and Nippon Ericsson. He obtained his BA in English Language from Kanagawa University in 1976



**Martin  
Sallenhag**

**Director of Product Marketing (35)**

With Dialog Semiconductor since 2001, and is responsible for the technical marketing of Dialog's product groups. Prior to joining Dialog Semiconductor, he held various management and engineering positions at Ericsson Mobile Communications and Axis Communications. He obtained his MSc in electrical engineering from the University of Lund, Sweden in 1992.



**Martin  
Klöble**

**Vice-President, Finance  
and Controlling (44)**

With Dialog Semiconductor since 1999. He was previously a partner with KPMG. Martin Klöble holds an MBA from the University of Stuttgart-Hohenheim and is qualified as a tax consultant (Steuerberater) as well as a certified public accountant in Germany (Wirtschaftsprüfer) and in the United States (CPA).



**Richard  
Schmitz**

**Vice-President, Engineering  
- Mixed Signal ICs (47)**

With Dialog Semiconductor since 1989, and responsible for design and development within the energy management & audio, RF, and automotive & industrial product groups. With a diploma in engineering for communications electronics, previous positions were at Hewlett Packard's instruments division in Böblingen, and the Institute for Microelectronics, Stuttgart.

## The Dialog Semiconductor Share

### The International Stock Markets in 2003

Following three consecutive years ending with a loss on the international stock markets, this trend was finally reversed in 2003 when stock markets around the world closed, in some cases, at a considerable year-on-year gain. At the beginning of 2003, the financial markets were affected by the fear of economic uncertainties resulting from the war in Iraq, and the persistently weak economy in industrial countries. However, prices later benefited from favorable early indicators and as a result of positive economic data from the USA, which led to a significantly improved likelihood of higher corporate profits. The resulting positive US stock market price development also had a direct subsequent impact on other stock markets in industrial nations.

The Dow Jones Index of the most important US industrials concluded the trading year with 10,453 points – above the important psychological 10,000 points benchmark and around 23 percent above the closing level of 2002. The technology market, NASDAQ, gained 50 percent in the year-on-year comparison and closed above the 2,000 points mark for the first time since January 2002. The Japanese leading index, Nikkei 225, also improved its position last year, by 26 percent.

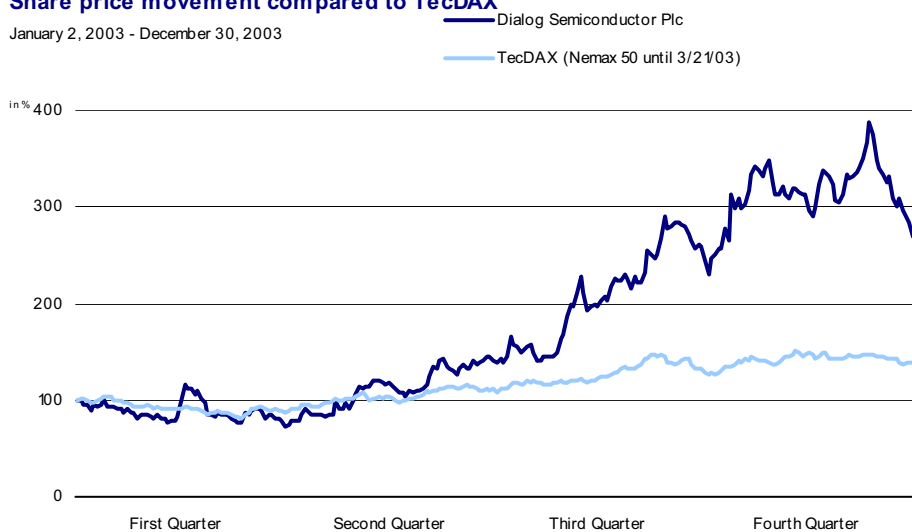
In comparison with the international leading index, the German DAX showed the greatest improvement in 2003: the index of the most important German leaders closed just below the 4,000 points mark, 37 percent higher than on the last trading day of the previous year. Against the annual low in March, the DAX gained around 83 percent. The TecDAX, the index that replaced the Nemax 50 on March 24, 2003 as part of the restructured stock market index, improved its position considerably and gained some 51 percent last year.

### The Dialog Semiconductor Share Performance

Our company share price benefited from these positive stock market developments.

#### Share price movement compared to TecDAX

January 2, 2003 - December 30, 2003



After an overall disappointing price performance in 2002, Dialog Semiconductor's shares began the 2003 trading year with a Xetra closing price of €1.13 (NASDAQ \$1.29). At the start of the new market year, our shares were also listed in the "Prime Standard", the new

Deutsche Börse quality segment established in 2003. Over the course of the first quarter, our shares showed predominantly sideways movement, in line with the general atmosphere of uncertainty on the international stock markets, and reached its annual low at €0.82 (NASDAQ \$0.95) on the last trading day of the first quarter.

At the start of the second quarter of 2003, the performance of Dialog Semiconductor shares was consistently positive and, from the middle of the quarter, for the first time, our shares performed better than the TecDAX. The share started the second quarter at €0.85 (NASDAQ \$0.95) and ended it with a Xetra closing price of €1.59 (NASDAQ \$1.80).

In the third quarter of 2003 – and continuing into the fourth quarter – Dialog Semiconductor shares showed considerably better performance than the TecDAX. Our shares attained an interim high at €3.28 (NASDAQ \$3.65) on September 9, when consistently high daily sales were achieved.

In the final quarter of 2003, the global economic recovery and the continued upturn on the capital markets were especially noticeable. Dialog Semiconductor shares showed distinctly positive development in the fourth quarter: with an annual high of €4.39 (NASDAQ \$5.52) on December 3, 2003, our shares recorded an increase of almost one hundred percent against the opening price in this quarter alone. The share ended the 2003 trading year with a Xetra closing price of €3.40 (NASDAQ \$3.45).

Looking back on 2003 stock market year as a whole, the impression is positive in view of the high trading volume of Dialog Semiconductor shares, as well as the clear improvement in performance against the TecDAX. Overall, more than 66 million Dialog Semiconductor shares were traded in 2003. At around 253,000 shares, the average daily trading volume was more than double the volume of the previous year. In the league table of indices for TecDAX shares as at December 31, 2003, Dialog Semiconductor closed in 28<sup>th</sup> position in terms of both stock market turnover and free float market capitalization. In the context of the forthcoming review of the composition of the share indices in February 2004, we believe that Dialog Semiconductor has a good chance of being included on the TecDAX for the first time.

## Market Prices

The following table shows, for the periods indicated, the highest and lowest closing market prices of our shares from the Frankfurt stock exchange (Xetra) and NASDAQ:

		2003		2002	
		High	Low	High	Low
Frankfurt (DLG)	First Quarter	€ 1.31	€ 0.82	€ 8.82	€ 4.40
	Second Quarter	€ 1.64	€ 0.85	€ 5.24	€ 1.67
	Third Quarter	€ 3.28	€ 1.56	€ 1.87	€ 1.00
	Fourth Quarter	€ 4.39	€ 2.90	€ 1.35	€ 0.70
NASDAQ (DLGS)	First Quarter	\$ 1.68	\$ 0.95	\$ 7.55	\$ 3.75
	Second Quarter	\$ 1.93	\$ 0.95	\$ 4.55	\$ 1.60
	Third Quarter	\$ 3.80	\$ 1.80	\$ 1.99	\$ 1.10
	Fourth Quarter	\$ 5.52	\$ 3.45	\$ 1.42	\$ 0.95
<b>Average trading volume per day</b>		<b>253,640</b>		<b>121,102</b>	

## Investor Relations: Dialog Semiconductor in Direct Contact with the Shareholders

Transparent and ongoing communication with the capital markets was at the center of our investor relations activities in fiscal 2003. The focus was, and continues to be, on opinion-shaping financial analysts and institutional investors. Following our delisting from Nasdaq Europe (formerly EASDAQ), our financial communication remains internationally oriented. Our origins as a British company and the international orientation of our business means financial analysts from the UK and the US are reporting on Dialog Semiconductor.

In addition to the DVFA (the German Society of Investment Analysis and Asset Management) analysts' conference for the 2003 annual results on February 26, Dialog Semiconductor last year organized four telephone conferences for analysts and investors to coincide with the publication of quarterly results. The Dialog Semiconductor management also held roadshows in Frankfurt, Cologne and London in March, September and November 2003. On top of this, some 35 individual meetings were held during the year with investors, analysts and the press worldwide.

The internet is the key source of information for analysts, institutional investors as well as for private investors. The investor relations sections of Dialog Semiconductor's internet web site are therefore a very important part of our investor relations work. Readers are able to find a wide range of documentation on the internet site, including share price overviews, press and ad hoc releases, financial reports and our financial reporting calendar.

### Investor Relations Activities in 2003

Date	Location	Event
February 17-19	Cannes	3 GSM world congress
February 26	Stuttgart, Frankfurt	Press and Analyst Conference of 2002 result
March 11	Frankfurt	Roadshow Dresdner Kleinwort Wasserstein
March 12	London	Roadshow Deutsche Bank
March 13	Zürich	Roadshow Bank Julius Bär
April 30	Conference Call	Release of first quarter results
May 15	London	Annual shareholders' meeting
July 23	Conference Call	Release of second quarter results
September 8-9	Frankfurt/Cologne/London	Roadshow with Bank Julius Bär
October 22	Conference Call	Release of third quarter results
November 30	Paris	Roadshow Dresdner Kleinwort Wasserstein

### Research Analyst Coverage

We greatly appreciate the ongoing communication with financial analysts. During 2003 the following analysts published reports about Dialog Semiconductor or covered us in their semiconductor peer group analysis.

Institution	Analyst
Areté Research	Brett Simpson
Berenberg Bank	Dr. Oliver Wojahn
BW Bank	Rüdiger Kühnle
Cazenove London	Ralph Jainz
CAI Cheuvreux	Jasmin Majewski
Dresdner Kleinwort Wasserstein	Annett Weber
DZ Bank	Harald Schnitzer
ING Bank	Stella Dombrowsky
Julius Bär	Ingo Queiser
LBBW	Uwe Barth
MM Warburg	Michael Bahlmann
SES Research	Oliver Drebing
WestLB Panmure	Dr. Karsten Iltgen

### Share Data as of December 31, 2003, (Share Prices derived from Frankfurt Stock Exchange, Xetra)

Security Identification Number (SIN)	927 200
Symbols	DLG
	NASDAQ: DLGS
Stock Exchanges	Frankfurt Stock Exchange (Prime Standard)
	NASDAQ, USA
Number of shares as of Dec. 31, 2003	44,068,930
Share price as of Dec. 30, 2003 (in €)	3.40
2003 High (in €)	4.39
2003 Low (in €)	0.82
Performance since offering	(64 %)
Trading volume per day (average 2003)	253.640
Market capitalization (in millions of €)	150
Basic loss per share 2003 (in €)	(0.46)

### Principal Shareholders

The following table sets out specified information with respect to the beneficial ownership of any person known by us to be the beneficial owner of more than 3% of our outstanding shares.

Name	Number	Percent
Apax Partners	8,460,793	19.2
Adtran, Inc.	2,520,960	5.7
Ericsson Radio Systems AB	2,101,554	4.8
Free float (1)	30,985,623	70.3
<b>Total</b>	<b>44,068,930</b>	<b>100.0</b>

(1) Of which 2,908,671 shares (6.6%) held by the The Capital Group Companies Inc as notified on February 11, 2004 on behalf of discretionary clients.

### Disclosure of Interests

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

# Corporate Profile

## Our Mission and Strategy

Dialog Semiconductor's mission is:

“To be the leading global supplier of mixed signal components and system level solutions to the wireless communications, automotive and industrial markets”

Our strategy is to further develop our technology core competence and integration expertise to develop leading-edge solutions for these chosen markets. Our commitment to a fabless business model, combined with partnerships with the world's leading companies in the electronics industry allows us to remain focused on taking advantage of our established experience to deliver innovative chip and system level solutions to our customers.

Partnerships are extremely important to Dialog Semiconductor since it is vital for us to compete on a level playing field with the semiconductor industry's leading players. These relationships range from excellent long-term partnerships with our key blue-chip customers, to links with companies like Intel Corporation and Bosch are an integral part of our research and development process, and other relationships in the product cycle are also essential. That is why we partner with the world's leading semiconductor foundries and assembly companies – so when our products reach the customer, quality is assured through our access to state-of-the-art manufacturing facilities, and our monitoring and control of every step of the production process right through to our own in-house testing of every component.

A common technology platform is an important part of our strategy – whether we're developing products for wireless, for automotive or for industrial applications, our strategy is determined by whether we have the ability to build upon our proven technology expertise in:

- Mixed signal design in CMOS manufacturing technology
- High performance analog circuit design
- High voltage capability in low power manufacturing processes
- Excellence in power management
- System on chip (SoC) integration

Our research and development team understands the design-critical issues of mixed analog and digital design, such as high voltages and noisy signals in low power digital circuits, and on their effects on power management systems. The resulting solutions include highly integrated power management and audio systems for cellular phones, complete image sensing and processing modules for embedding into handheld equipment, comfort electronics systems in cars, and electronic ballasts for industrial lighting systems.

In summary Dialog Semiconductor's strategy is focused on:

- Developing innovative silicon solutions based on mixed signal CMOS and high performance analog and digital design
- Developing leading-edge power management, audio, imaging and display products for wireless, automotive and industrial markets
- Delivering complete, high volume standard product or custom silicon solutions to our customers globally
- A fabless business model, delivering high-quality, in-house tested products manufactured through world-leading manufacturing and assembly suppliers

## Our Business and Markets

### The Business – Delivering Innovative Silicon Solutions

Dialog Semiconductor develops and supplies innovative mixed signal and system level integrated circuit solutions for wireless, automotive and industrial applications, with a proven track record in delivering qualified and tested chips to the world's top original equipment manufacturers.

Our business is based upon expert knowledge and experience in the design of complex analog and digital circuits, resulting in leading-edge standard products and application specific IC (ASIC) solutions for power management, audio processing and image sensing. As a fabless semiconductor company, we design and develop innovative semiconductor solutions, outsource high-volume production, test and approve final products at Dialog before delivery to our customers.

Our technology enables advanced applications and sophisticated new end-user features in electronics systems, including:

- longer standby times and hi-fi quality voice on mobile phones
- digital audio player (MP3 and others) functions on mobile phones
- image sensing and processing for multimedia messaging on mobile phones
- high quality, high resolution color displays in portable products
- chips for automotive comfort electronics and sensors in airbag systems
- system on chip (SoC) for applications such as ballasts for fluorescent lamps

### Our Markets

Dialog Semiconductor's innovative semiconductor solutions address the wireless communications, automotive electronics and industrial systems markets.

Our extensive knowledge of designing for **wireless communications** means a significant part of Dialog's business is from chips for mobile phones - our power management and audio devices are used in well over 400 million mobile phone handsets. Handset manufacturers benefit from our expertise in low power mixed signal circuit design to deliver a range of highly integrated chip and system-level solutions for mobile and cellular handsets, addressing requirements across 2.5G, 3G, GPRS and CDMA wireless systems.

Dialog's portfolio also includes a range of image sensors, camera modules and color liquid crystal display drivers, allowing designers to embed high-performance, high-resolution digital still camera and video functionality into current and next generation handsets.

In **automotive electronics**, our focus is on chips for engine management and comfort electronics. We also partner with automotive manufacturers for high voltage (40V) system-on-a-chip (SoC) development.

In **industrial systems**, our established mixed signal components include dimming, control, sensor and power management ASICs for use in lighting systems, as well as single chip solutions for the control of fluorescent lamps.



## Our History

Dialog Semiconductor originated from the European activities of a US semiconductor company, International Microelectronic Products, Inc. ("IMP"), founded in 1981 in Silicon Valley, specializing in mixed signal CMOS semiconductor technology. Key milestones:

- 1988:** Supplied analog cellular audio processors for NMT/TACS/AMPS
- 1989:** Started development of first GSM audio processor
- 1990:** Daimler-Benz AG, now DaimlerChrysler AG, acquired IMP Europe; became part of the Daimler-Benz AG subsidiary, Temic Telefunken Microelectronic GmbH
- 1996:** Introduced first system level CMOS power management device
- 1998:** Apax Partners, Adtran and Ericsson financed management buy-out from Daimler-Benz AG. Dialog Semiconductor becomes a public limited company constituted under the laws of England and Wales
- 1999:** Dialog Semiconductor initial public offering (IPO) on Frankfurt Stock Exchange
- 2000:** Dialog Semiconductor listed on NASDAQ exchange
- 2000:** Supplied the first 3G power management and audio device
- 2001:** Developed digital camera accessory module for mobile phones, incorporating all elements for capturing and manipulating images
- 2002:** Acquired CMOS imaging business and associated CMOS Active Pixel Sensor (APS) patent portfolio from Sarnoff Corporation
- 2002:** Launched full VGA resolution, standard camera modules for high quality photo imaging and video in mobile phones and personal digital assistants (PDAs)
- 2003:** Launched first highly integrated audio and power controller for GSM/GPRS cellular phone handsets as part of development and marketing initiative with Intel Corporation

## Our Products

Our product strategy is clearly focused to address Dialog Semiconductor's target markets of wireless communications, automotive and industrial systems. These product categories, which all make use of a common technology platform and design expertise, are:

- Power management and audio ICs
- Camera modules
- Liquid crystal display drivers
- Application specific ICs

### Power management and audio ICs

The customer preference for smaller and more sophisticated hand-held and portable devices with advanced capabilities such as wireless communications, digital camera, video and audio all in the same device places huge demands on the battery. Our highly integrated, single chip power management and audio devices ensure the components within a mobile phone handset or personal digital assistant (PDA) make optimum use of the battery to prolong usage time, and also to provide high performance audio playback.

In 2003, we introduced a patented technique called Smart Mirror™, which allows product designers to minimize current consumption and simplify their designs by eliminating 'power-down' modes. This was first introduced in our DA9010 integrated GSM/GPRS audio and power controller. Developed in collaboration with Intel Corporation, the DA9010 provides all the necessary power management and high performance audio functions for the phone handset chip design, offering a level of integration not previously available in this class of device.

In addition to standard products, our power management and audio functions are also available to customers as application specific ICs (ASICs). The power management functions are also used in ASICs for automotive electronics and industrial lighting systems.

Power management functions from Dialog Semiconductor include:

- Smart mirror™ LDO (low dropout voltage) regulators
- High efficiency buck and boost converters
- Programmable multiple chemistry battery chargers for all common battery technologies, NiMH, L ion and polymer

Dialog's advanced audio codec functions have up to 24-bit capability for digital audio player algorithms like MP3 and beyond, and are based on Dialog's own digital signal processing (DSP) designs optimized for minimum power consumption and silicon area. A range of high performance analog interfaces for microphones, loudspeakers and line drivers supports these audio codecs.

### Camera modules

The use of camera phones and personal digital assistants (PDAs) with cameras is already widespread and market analysts predict further growth in this area. Cameras are also becoming part of automotive guidance and collision avoidance systems. Dialog Semiconductor provides a range of CMOS image sensors and stand-alone modules for

image sensing and processing, allowing manufacturers to embed high performance, high-resolution camera functionality into next generation consumer products and automotive systems.

The unique XDR® (extended dynamic range, a registered trademark of Dialog Semiconductor) technology in our image sensors ensures clear images are captured under widely contrasting ambient light, offering best of class performance in low light conditions. Key features of our image sensor technology include:

- Superior video in outdoor uncontrolled lighting
- Antiblooming
- High confidence image capture
- Fast response
- Very low power and low voltage
- High resolution still and streaming video modes

Our advanced embedded camera-on-a-chip products range from standalone CMOS image sensors to the complete module consisting of sensor, image DSP, lens, housing and connector. The high sensitivity and processing capability down to each pixel makes our image sensor technology the ideal choice for automotive systems, where near real-time response is required.

#### Liquid Crystal Display Drivers

In 2003, we developed a family of devices which drive color displays in wireless handsets, aimed primarily at the growing number of color display manufacturers in Asia. The color STN (super-twisted nematic) liquid crystal display (LCD) drivers provide excellent resolution of up to 65,000 colors. They address a growing trend for mobile phone users to demand more information from their display, such as in video and gaming.

Our display drivers address a demand for higher performance full color, high speed moving images using MLA (multi-line addressing) LCD technology – ensuring faster response time compared to conventional passive matrix displays. MLA LCDs support moving images at high speeds while maintaining very low power consumption.

#### Application specific ICs

Dialog Semiconductor's background in developing ASIC (application specific integrated circuit) solutions for wireless, automotive and industrial products allows us to rapidly develop leading-edge application specific solutions for our customers based on proven in-house technology and the latest CAD tools.

Our ASIC solutions are manufactured by leading foundry partners, to ensure our customers can access the latest CMOS processes and foundry capacity. This allows our customers to meet both costs and time-to-market objectives for their products.

In **cellular phones**, we have developed over 50 different power management designs for the world's leading cellphone manufacturers. As handset technology evolved, we developed increasingly integrated ASICs with many power management functions on the chip – such as high performance LDOs (low drop out voltage regulators), high efficiency DC-DC converters, complete battery charging circuits, programmable LED drivers and USB interfaces.

In **automotive** electronics, a number of different ASICs developed by Dialog control safety, engine management, and comfort electronics for the top automobile manufacturers. Our ASICs exploit Dialog's competence in power management systems and mixed signal design, together with our knowledge of integrating high performance analog circuits, and high-density digital logic and high voltage circuits on a single chip, in a standard CMOS process.

In **industrial** systems, we've developed single chip solutions that integrate high voltage low power circuits for electronic ballasts used to control fluorescent lamps. The technology used in the electronic ballast ASIC forms the basis of highly integrated control chips for smart power electronics systems in other applications such as computer and mobile communications systems. Dialog's solution is ideal for instances where the chip must be highly integrated yet have the ability to control high voltages intelligently using digital circuits on the same chip.

# Management Report

## Economic Development in our Market

The key trends in 2003 dominating the markets addressed by Dialog Semiconductor were:

- market recovery in cellular handset shipments during the second half of 2003
- growth in semiconductor sales worldwide in the second half of 2003
- growth in Asia, of both cellular handset manufacturers and handset sales
- convergence of mobile phone, personal organizer and digital camera technologies in the 'smart' phone and personal digital assistant (PDA)
- growth in automotive electronics

The second half of 2003 saw a turnaround in cellular handset sales, with the total number expected to reach over 500 million for the whole year (Dataquest; January 2004). A significant part of this growth was led by Asia, and in particular, China, Korea and Japan. Dialog Semiconductor witnessed a corresponding increase in interest from manufacturers in Asia, both for power management and audio chips as well as image sensor and display driver technology. This interest was in the form of enquiries for our products, particularly driven by the need to add high performance digital camera capability, improved and multiple displays, plus much more efficient management of power consumption to account for the more power-hungry, sophisticated multimedia features of the phone.

Worldwide there were growing sales of 'smart' phones, camera phones and PDAs featuring wireless and multimedia capabilities during 2003. According to market research firm Strategy Analytics, camera phones outsold digital still cameras in the first half of 2003, and for the full year, 65 million camera phones were expected to be sold. With PDAs, over 11 million units were expected to be sold in 2003, according to another research firm, In-Stat/MDR. Significantly, In-Stat/MDR says manufacturers are increasingly making PDAs more than just PC peripherals and are adding features such as integrated GPS and high-resolution multi-mega pixel cameras with flash and zoom functionality.

We expect this convergence of devices will be a key driver of growth over coming years for Dialog Semiconductor, as a supplier of innovative semiconductor solutions and components to the manufacturers of mobile phone handsets.

The market for CMOS image sensors also grew as a result of the increase in sales of camera phones and smart phones, as well as in automotive applications. The total image sensor market in 2003 (for CCD sensors and CMOS sensors) was forecast to be over US\$2.6 billion (according to Strategies Unlimited); although this has largely been from CCD sensors, the lower power CMOS sensors are gaining sales in both high and low end applications. Dialog Semiconductor is seeing signs of success for our CMOS image sensors and camera modules.

With legislative, environmental, competitor and consumer demands in the automotive environment, the global demand for electronics within this sector continues to grow. In particular, the demand for electronics components is expected to grow 12.1 per cent in dollar revenue between 2002 to 2007, according to Strategy Analytics. Dialog Semiconductor's technology addresses the demand for comfort and safety electronics.

## Operating and Financial Review

### Forward-looking statements.

The annual report contains "forward-looking statements". All statements regarding our future financial condition, results of operations and businesses, strategy, plans and objectives are forward-looking. Statements containing the words "believes", "intends", "expects" and words of similar meaning are also forward-looking. Such statements involve unknown risks, uncertainties and other factors that may cause our results, performance or achievements or conditions in the markets in which we operate to differ from those expressed or implied in such statements. These factors include, among others, product demand, the effect of economic conditions and conditions in the semiconductor and telecommunications markets, exchange-rate and interest-rate movements, capital and credit market developments, the timing of customer orders and manufacturing lead times, the changes in customer order and payment patterns, the financial condition and strategic plans of our major customers, insufficient, excess or obsolete inventory, and the impact of competing products and their pricing, product development, commercialization and technological difficulties, political risks in the countries in which we operate or sale and supply constraints. It is not possible to predict or identify all such factors. Consequently, any such list should not be considered to be a complete statement of all potential risks or uncertainties. We do not assume the obligations to update forward-looking statements.

The following table sets forth historical consolidated statements of operations of Dialog for the fiscal years ended December 31, 2003, 2002 and 2001 in thousands of Euro and as a percentage of revenues:

(in thousands of €)	Year ended December 31,					
	2003	%	2002	%	2001	%
Revenues	92,893	100.0	77,104	100.0	100,519	100.0
Cost of sales	(62,374)	(67.2)	(57,409)	(74.4)	(80,574)	(80.2)
<b>Gross margin</b>	<b>30,519</b>	<b>32.8</b>	<b>19,695</b>	<b>25.6</b>	<b>19,945</b>	<b>19.8</b>
Selling and marketing expenses	(4,197)	(4.5)	(4,149)	(5.4)	(4,054)	(4.0)
General and administrative expenses	(5,044)	(5.4)	(6,447)	(8.4)	(5,569)	(5.5)
Research and development	(30,590)	(32.9)	(34,530)	(44.8)	(31,256)	(31.1)
Amortization of intangible assets	(2,073)	(2.2)	(1,975)	(2.5)	(3,202)	(3.2)
Restructuring and related impairment charges	(1,839)	(2.0)	–	–	–	–
<b>Operating loss</b>	<b>(13,224)</b>	<b>(14.2)</b>	<b>(27,406)</b>	<b>(35.5)</b>	<b>(24,136)</b>	<b>(24.0)</b>
Interest income, net	757	0.8	1,121	1.5	898	0.9
Foreign currency exchange gains and losses, net	(454)	(0.5)	(1,918)	(2.5)	1,713	1.7
Recovery (write-down) of investment	315	0.3	11,969	15.5	(42,405)	(42.2)
<b>Result before income taxes</b>	<b>(12,606)</b>	<b>(13.6)</b>	<b>(16,234)</b>	<b>(21.0)</b>	<b>(63,930)</b>	<b>(63.6)</b>
Income tax (expense) benefit	(7,814)	(8.4)	6,026	7.8	22,544	22.4
<b>Net loss</b>	<b>(20,420)</b>	<b>(22.0)</b>	<b>(10,208)</b>	<b>(13.2)</b>	<b>(41,386)</b>	<b>(41.2)</b>

## Results of Operations

### Revenues

Revenues were €92.9 million for the year ended December 31, 2003 compared with €77.1 million for year ended December 31, 2002. The increase of 20% in revenues is primarily due to new products introduced to volume production in the second half of 2002 with more functionality and accordingly, higher average selling prices. Our revenues for 2003 reflected the inclusion of sales of those new products. Our increased revenues in 2003 also reflect the general increase in cellular handset sales in the second half of 2003 (particularly in Asian markets). Revenues in the wireless communications sector were €69.8 million for the year ended December 31, 2003 compared with €54.7 in 2002, comprising 75% and 71% of our total revenues in the years ended December 31, 2003 and 2002, respectively. Revenues from our industrial applications sector were €12.8 million or 14% of total revenues in 2003 and €13.7 million or 18% of total revenues in 2002. Revenues from our automotive applications sector were €7.9 million and €6.1 million, representing 9% and 8% of our total revenues in 2003 and 2002, respectively. Other revenues were €2.4million, or 2% of total revenues, a decline of €0.2 million when compared to the €2.6 million, or 3% of total revenues, in 2002.

Due to the shipments of new products in volume production to the market we expect revenues for the year ended December 31, 2004 to be higher than those for the year ended December 31, 2003. However, our forward visibility with respect to customer demand is limited and a successful introduction of new products depends on the completion of new designs on a timely basis. Our revenues for 2004 will also be highly dependent on continued growth in the worldwide market for cellular handsets, which began in the second half of 2003. We cannot give any assurance that this growth trend will continue throughout 2004.

### Cost of Sales

Cost of sales consists of the costs of outsourcing production and assembly, related personnel costs and applicable overhead and depreciation of test and other equipment. Cost of sales increased by 9% from €57.4 million for the year ended December 31, 2002 to €62.4 million for year ended December 31, 2003 in line with increased production volumes. In addition, as a result of higher production volume, our internal testing operation has been running at an increased utilization level, which in turn has decreased per unit production costs and decreased cost of sales as a percentage of total revenues. Because we have a number of products that we expect to introduce to volume production in 2004, we expect per unit costs to increase in the near term.

### Gross Margin

Our gross margin increased from 25.6% of revenues for year ended December 31, 2002 to 32.8% of revenues for the year ended December 31, 2003. The decrease in per unit production costs was the primary factor contributing to an increase in our gross margin.

We expect the near term future gross margin percentage to be slightly below the gross margin percentage achieved in 2003 as a result of the expected introduction to volume production of new products (with high unit costs and thus lower initial margins in their ramp-up phase) during 2004.

### **Selling and Marketing Expenses**

Selling and marketing expenses consist primarily of salaries, travel expenses and costs associated with advertising and other marketing activities. Selling and marketing expenses were €4.2 million and €4.1 million for the year ended December 31, 2003 and 2002, respectively. As a percentage of total revenues, selling and marketing expenses decreased from 5.4% to 4.5%.

### **General and Administrative Expenses**

General and administrative expenses consist primarily of personnel and support costs for our finance, human resources, information systems and other management departments. General and administrative expenses decreased from €6.4 million for the year ended December 31, 2002 to €5.0 million for the year ended December 31, 2003, primarily as a result of the closure of our Swedish subsidiary. As a percentage of total revenues, general and administrative expenses decreased from 8.4% to 5.4%.

### **Research and Development**

Research and development expenses consist principally of unreimbursed design and engineering related costs associated with the development of new ASICs and application specific standard products ("ASSPs"). Research and development expenses decreased 11% from €34.5 million for the year ended December 31, 2002 to €30.6 million for the year ended December 31, 2003. The decrease in research and development expenses results from cost savings following the closure of our Swedish subsidiary. Research and development expenses decreased from 44.8% to 32.9% as a percentage of total revenues, resulting from the absolute decrease and the proportionately higher revenue base. We expect continued demand from key customers for us to assist in the development of new products for them and also expect to continue to incur research and development costs in connection with the development of ASSPs. Accordingly, we expect research and development expenses to increase somewhat in absolute terms in 2004. Our ability to generate long-term revenues from our research and development programs depends on customers accepting our designs and implementing them in large-scale production.

### **Amortization of Intangible Assets**

Amortization expenses for the year ended December 31, 2003 was €2.1 million as compared to €2.0 million for year ended December 31, 2002, an increase of 5%. Amortization expense for intangible assets includes ASIC design software, a 16 bit microprocessor core, other intangible assets and certain imaging patents.

### **Restructuring and Related Impairment Charges**

In the second quarter of 2003 we closed our Swedish subsidiary. In connection with the closure of the facility, we recorded restructuring charges of €1.5 million and impairment charges of €0.3 million, totaling €1.8 million for the year ended December 31, 2003. Restructuring charges include termination benefits of €1.0 million that were paid to all employees affected by the closing and a provision of €0.5 million for estimated costs that will continue to be incurred under an executory contract for its remaining term without economic benefit to the Company. See Note 3 to the consolidated financial statements for further information.



### Operating Loss

We reported an operating loss of €13.2 million for the year ended December 31, 2003 and €27.4 million for the year ended December 31, 2002, a decrease of 52%. This decrease in operating loss was primarily due to a higher gross margin, the impact of which was partially offset by restructuring and related impairment charges in the year ended December 31, 2003.

### Interest Income, net

Interest income, net from the Company's investments (primarily short-term deposits) was €0.8 million for the year ended December 31, 2003 and €1.1 million for the year ended December 31, 2002.

### Foreign Currency Exchange Gains and Losses, net

Foreign currency exchange losses, net were €0.5 million for the year ended December 31, 2003 and €1.9 million for the year ended December 31, 2002. This decrease was primarily due to the re-measurement of our outstanding US Dollar advance payment to two wafer suppliers, of which the most significant is with Chartered Semiconductor Manufacturing Pte., Ltd. ("Chartered"). Such advance payments are classified in the balance sheet line items "Prepaid expenses". In the second quarter of 2003 we concluded that it was appropriate to account for our advance payments as "monetary assets" for the purpose of re-measuring the outstanding balance into Euro, with the resulting exchange gains or losses recorded in the statements of operations. Accordingly, certain prior period amounts presented have been revised to reflect this re-measurement process. We believe that the impact of this re-measurement, using the then current exchange rates applicable for those periods impacted (rather than the historical exchange rate at the time we entered into the relevant contracts) does not have a material effect on any financial statements previously issued or on our 2003 financial statements. See Note 4 to the consolidated financial statements for further information.

### Recovery of Investment

In the fourth quarter of 2001, we determined that our ability to recover the full amount of our investments in silicon supplier ESM Holding Limited ("ESM") was impaired. Accordingly we wrote off our investments in ESM. In March 2002, International Rectifier acquired ESM. As a result we were able to recover €0.3 million and €12.0 million for the years ended December 31, 2003 and 2002, respectively.

### Income Taxes

Income tax expense was €7.8 million for the year ended December 31, 2003 compared with €6.0 million income tax benefit for the year ended December 31, 2002. The change in income taxes mainly reflects a valuation allowance on deferred tax assets of €11.8 million primarily related to the uncertainty about the future realizability of our German tax-loss carryforwards.

In December 2003, the German government enacted new tax legislation, which among other things, limits the use of German tax-loss carryforwards to 60% of the taxable income for fiscal years starting from 2004 and thereafter. We have evaluated our deferred tax asset position and the need for a valuation allowance as a result of this change in tax law. The assessment requires the exercise of judgment on the part of our management, with respect to, among other things, benefits that could be realized from available tax strategies and future taxable income, as well as other positive and negative factors. The

ultimate realization of deferred tax assets is dependent upon our ability to generate future taxable income sufficient to utilize loss carryforwards. Our assessment considered the weight given to cumulative tax losses incurred in Germany over the three-year period ended December 31, 2003, as well as detailed forecasts of taxable income in the foreseeable future. Although we forecast generating future taxable income, the change in tax law increases the forecasted number of additional years we must generate such future taxable income in order to fully realize these loss carryforward benefits. Pursuant to SFAS 109 and the inherent uncertainties in projecting future taxable income, we concluded that it is more likely than not that a portion of our tax losses may not ultimately be realized. Consequently, we recognized an additional valuation allowance as of December 31, 2003 of €11.8 million, to reduce the carrying value of our net deferred tax assets to an amount that we believe is more likely than not expected to be ultimately realized.

**Net Loss**

For the reasons described above, we reported net loss of €20.4 million for the year ended December 31, 2003 compared with net loss of €10.2 million for the year ended December 31, 2002.

## Liquidity and Capital Resources

### Cash flows

Cash provided by operating activities was €7.6 million for year ended December 31, 2003 compared with cash used for operating activities of €7.6 million for the year ended December 31, 2002. In the year ended December 31, 2003, our working capital (excluding cash and cash equivalents and marketable securities) decreased primarily due to contractually required refunds of advanced payments from a silicon supplier in proportion to our wafer purchases and resulted in a related operating cash inflow. The outstanding balance of the advance payments is classified in the balance sheet under "Prepaid expenses". In the year ended December 31, 2002, we used cash primarily to finance our working capital.

Cash used for investing activities was €30.3 million for the year ended December 31, 2003 compared with cash provided by investing activities of €6.1 million for the year ended December 31, 2002. Cash used for investing activities for the year ended December 31, 2003 consisted mostly of the purchase of marketable securities of €45.0 million, the purchase of test equipment, tooling (masks), laboratory and EDP equipment of €5.9 million, and the purchase of software, licenses and patents of €1.4 million. In October 2003, we also received an early repayment of our deposit of €21.7 million (USD 20 million) from Chartered. Cash provided by investing activities in the year ended December 31, 2002, reflects primarily the payment we received in connection with the recovery of a portion of our ESM investment of €12.0 million.

### Liquidity

At December 31, 2003 we had €8.1 million in cash and cash equivalents, €44.9 million in marketable securities and had working capital of €71.9 million.

Our primary sources of liquidity have historically been cash from operations, cash from the issuance of ordinary shares, short-term borrowings, the recovery of the investment in ESM Limited and in 2003 the early repayment of a deposit from Chartered. As of December 31, 2003 we had no long-term debt. We expect to use a portion of our cash and cash equivalents and marketable securities in 2004 to finance working capital resulting from expected increased business volumes. A decrease in customer demand for our products caused by unfavorable industry conditions or an inability to develop new products in response to technological changes could materially reduce the amount of cash generated from operations.

If necessary, we have available for use a short-term credit facility of €12.8 million that bears interest at a rate of EURIBOR + 0.75% per annum. At December 31, 2003 we had no amounts outstanding under this facility. Accordingly, we believe the funding available from these and other sources will be sufficient to satisfy our working capital requirements in the near to medium term.

### Capital Expenditures and Investments

Purchases of property, plant and equipment were €5.9 million for the year ended December 31, 2003 compared to €3.9 million for the year ended December 31, 2002 and €3.2 million for the year ended December 31, 2001. Our capital expenditures in 2003, 2002 and 2001 consisted primarily of purchasing new or replacement test systems, tooling equipment, handling systems and other equipment in the ordinary course of our business.

In 2003 and 2002 we paid installments of €0.8 and €1.5 million, respectively, for the CMOS imaging technology and associated CMOS Active Pixel Sensor (APS) patents which we acquired in 2002. A further installment of €0.5 million is payable in cash or company shares (at our option) when certain CMOS imaging sensors (“imagers”) have been successfully developed by Sarnoff Corporation. See Note 13 to the consolidated financial statements for further information. We expect capital expenditures in 2004 will approximate the 2003 level.

In future periods, we may make strategic investments or acquisitions in connection with our plans to expand our business internationally.

#### Off-Balance Sheet Arrangements and Other Commitments

We have no off-balance sheet arrangements involving variable interest entities. We lease design software, all of our office facilities, office and test equipment, and vehicles under operating leases. Future minimum lease payments under rental and lease agreements, which have initial or remaining terms in excess of one year at December 31, 2003 are as follows (€ thousands):

	2004	2005	2006	2007	2008	Thereafter
Operating leases	8,729	8,140	377	171	167	484

To hedge existing foreign currency exposure we purchased foreign currency forward contracts in 2000 to effectively change the US Dollar deposits (\$20 million) into Euro (€21.7 million) and in the fourth quarter of 2003, we entered into derivative financial arrangements with a bank that obligates us, if directed to do so, to purchase a total of \$3.6 million during the first half of 2004 at euro-dollar exchange rates ranging from 1.22 to 1.24. See Note 18 to the consolidated financial statements.

We have no long-term debt, capital lease obligations, unconditional purchase obligations or any other long-term obligations that would have a material impact on our liquidity or financial condition. We have supply agreements with Chartered and another supplier and maintain an outstanding balance of advance payment of \$1.7 million at December 31, 2003 with Chartered and €1.3 million with the other supplier, which will be refunded in proportion to our purchases of wafers. See Note 11 to the consolidated financial statements.

#### Dividends

We did not pay dividends in the years ended December 31, 2003, 2002 and 2001. We do not currently plan to pay dividends in the foreseeable future.

## Research and Development

Dialog Semiconductor has a considerable reputation among our customers in creating innovative mixed signal silicon solutions in 100% CMOS technology, fully tested and delivered to achieve our customers' time-to-market needs. Hence our research and development activity focuses on developing new design solutions and techniques that help manufacturers to

- put more features into smaller, faster, more complex consumer electronics products
- manage the growing electronics systems in automotive environments
- handle high voltages in automotive electronics, industrial and wireless systems

To do this, we focus our research and development on furthering our technology expertise in power management, audio-CODECs, image sensors and systems, and display driver technology. It also means improving our knowledge of implementing electronic circuits in the latest commercially available CMOS manufacturing technologies.

In 2003, we spent approximately €31 million on research and development, a significant investment as a proportion of total revenue. As the consumer, automotive and industrial electronics markets advance so rapidly, it is vital for Dialog Semiconductor to continue to expand our design teams and system design know-how to fulfill the leading edge silicon solution requirements of our customers. This expertise includes software development, state-of-the-art digital system design, and leading edge analog design. By innovating in these areas we are able to offer equipment manufacturers:

- combined audio and power management in one chip to meet the demands of smaller and less expensive systems
- extended audio-CODEC performance for high quality audio, built-in radios and MP3 players in mobile phones
- efficient power management for maximum standby and talk times utilizing Dialog's Smart Mirror™ technology and dynamic voltage management (DVM)
- imaging, data conversion and digital image processing for camera and video-enabled mobile phones
- wireline interface solutions for transmission standards such as T1, T3, HDSL, SDSL and G.shdsl, for improved efficiency in high speed, high bandwidth networks
- signal conditioning components for airbag system sensors.
- dimming, control, sensor, and power management ASICs for lighting systems

In addition, in line with the needs of the latest and next generation products, Dialog Semiconductor continues to develop its skills in:

- further system on chip (SoC) integration
- state-of-the-art process CMOS technologies, from 0.35μ down to 0.18μ
- imaging technology for consumer, mobile and automotive camera integrators
- high voltage (40V) integration with low voltage circuits on the same chip

### Technologies

Dialog Semiconductor was one of the first companies to introduce mixed signal system-level power management solutions in CMOS technology. We continue to develop our use of purely CMOS technology, rather than specialist analog or mixed manufacturing

technologies, using the latest commercially available feature sizes for high volume products. In 2003, we moved from 0.35  $\mu$  down to 0.25  $\mu$  and 0.18  $\mu$  processes. However, it is not enough just to be using CMOS technology, since we believe that our competitive edge over other companies is our expertise in knowing how to use this technology for products using mixed signal designs. For example, it is important to understand the implication of high voltage and low power in a state of the art 0.13  $\mu$  technology.

Using deep submicron CMOS technology also allows the integration of more digital features in analog circuits – many sophisticated features in consumer and automotive electronics systems are enabled by digital microcontroller-type circuits. In industrial systems, this is also true, where we are able to integrate low voltage digital control circuits in high voltage switching applications – in electronic ballasts for example.

All our **power management** and **audio** products use mainstream CMOS manufacturing technology. Unit production costs can be up to 20-25% lower on CMOS compared with alternative manufacturing technologies for the same or similar functionality.

In **imaging**, we use proven, mature CMOS technology for high volume markets, using standard fabrication processes to ensure lowest manufacturing cost for camera-on-a-chip designs. Our CMOS APS (active pixel sensor) technology is ideal for very low voltage, low power and high confidence visible light and NIR (near infra-red) image capture, and enables one of the smallest and lowest power vision systems capable of handling up to 100 frames per second operation from a power supply as low as 2.5V.

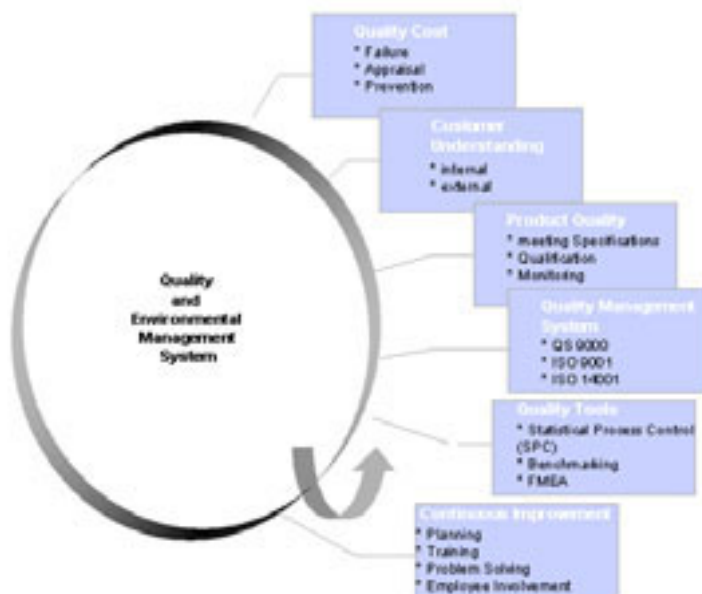
In **automotive** applications, power management chips are often connected directly to a battery and experience voltages of up to 40V. Integrating high and low voltage components in a standard CMOS process has traditionally been difficult. Dialog Semiconductor has developed these components in a CMOS process to allow integration of high performance analog circuits, embedded flash memory, microcontroller, high-density digital logic and high voltage circuits on a single chip. This enables the benefits of integration, as well as the advantage of standard CMOS technology.

## Quality and Environment

As a fabless semiconductor company, Dialog Semiconductor's business model is based on strategic outsourcing. In order to achieve the highest quality we must demand world-class quality standards from both our fabrication and assembly partners as well as our own internal processes to increase our customers' confidence in our products. Dialog Semiconductor is accredited to QS9000/ISO9001:2000/ISO14001 and as an extension of this practice it is our policy to build partnerships with suppliers that are also qualified to the same international quality standards.

Our main quality goals are zero defects and continuous improvement of both product and process quality, which requires an uncompromising approach to quality assurance in every area of our operations, through active participation from every employee within the company. This produces a highly structured quality environment that has resulted in Dialog Semiconductor being approved by all our major blue-chip customers.

A representation of our Quality and Environmental System model is shown below:



### Qualification and Approvals

As more new designs and products require advanced wafer processing technologies, over 90% of our product qualification and monitoring sampling programs are based around deep sub micron technology. We also have a formal automotive qualification program with chosen wafer fabrication and assembly partners.

Following an audit by Sony Corporation, Dialog achieved certification as a "Sony Green Partner" in Q4 2003.

### The Environment and Environmental Protection

Dialog Semiconductor's commitment to the environment is illustrated by our ISO14001 certification. We firmly believe that sustainable development can only be secured if we take care of our valuable resources, which is why we deal only with suppliers with similar environmental goals. We have raised awareness within our own organization such that environmental issues have become an instinctive part of the decision making process.

Our Environmental Management System was designed to be a matrix system involving our main offices located in Kirchheim / Teck-Nabern, Munich and Heidelberg in Germany, Swindon in the UK and Clinton in the USA. Our integrated activities focus on the protection of our environment by using environmentally friendly production technology. Examples of this are:

- implementation of lead-free and green packaging technologies
- reduction and elimination of ozone-depleting chemicals
- reduction of hazardous substances
- reduction of waste by maximizing product yields



## Our Employees and Facilities

### High Staff Retention in a Challenging Market

Dialog Semiconductor has withstood the challenges of the last three years with a very high employee retention rate – as at December 31, 2003, we employed 273 people across seven locations worldwide. The ability to retain quality engineering, research, sales, marketing, finance and administrative staff is a tribute to our staff development opportunities and the stimulating environment which encourages leading edge design and development in a global semiconductor market.

The continued motivation of our staff is therefore an important part of our human resources policy. This allows us to effectively build on our key market strengths, explore new product and market development opportunities, and deliver what our customers need.

The Management would like to thank all employees for their hard work and commitment during the past year.

### International Outlook, Local Support

A global presence is an important aspect of competing in the modern electronics industry, particularly when design and development can take place at one location, manufacturing at another, and testing at a different place.

At Dialog Semiconductor, our competitive advantage can only be maintained by having a global presence with localized support for customers. Hence we are represented in the most important technology development and manufacturing markets worldwide and managed from headquarters in Germany. Dialog has a total of seven offices across Europe, the USA and Japan, allowing us to support customers close to where they need us. Asia, in particular, is a rapidly growing market and is addressed through our office in Tokyo plus local representatives in the region. Our direct local support is highly valued by our customers and complements their development activities.

Individual design centers at Dialog operate by having small design teams which constantly exchange knowhow with other teams in other locations, enabling them to focus on innovative design work. Using uniform design software and IT infrastructure, they can then drive product developments forward at multiple locations simultaneously.

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

Location	Principal Use
Neue Strasse 95, Kirchheim/Teck-Nabern, Germany	Company headquarters, office operation for sales, marketing, design and testing
Windmill Hill, Swindon, Wiltshire United Kingdom	Office operation for sales, marketing and design
54 Old Highway 22, Clinton, New Jersey, USA	Office operation for sales, marketing and design
16870 West Bernardo Drive, San Diego, California, USA	Office operation for sales
Aomi Frontier Building 9f 43, Aomi 2-chome Koto-ku / Tokyo, Japan	Office operation for sales, marketing and design
Mannheimer Strasse 1 Heidelberg, Germany	Office operation for design
Industriestrasse 1 Munich/Germering, Germany	Office operation for design
Kärntner Strasse 518 Graz-Seiersberg, Austria	Office operation for design

## Risk Factors

The market in which we compete is characterized by continuous development and technological improvement. As a result, our success depends on our ability to develop new designs and products on a cost effective, timely basis. Our future success also depends on our ability to anticipate and respond to new market trends, to rapidly implement new designs which satisfy customers' desires, and to keep abreast of technological changes within the semiconductor industry generally. It is not possible to predict or identify all relevant risk factors and, therefore, the following list should not be considered to be a complete statement of all potential risks or uncertainties.

- We have not been profitable for the last three fiscal years, and there is no guarantee that we will return to profitability
- Our revenues, profitability and growth could decline if the growth of the wireless communications market slows
- We may become a passive foreign investment company
- If we are unable to adapt rapidly to changing markets and technology, we may lose customers and be unable to develop new business
- The semiconductor industry is highly cyclical in nature and this results in periodic overcapacity
- We face intense competition, and if we are unable to compete effectively or if we are unable to adapt rapidly to changing markets and technology, we could lose customers and be unable to develop new business
- The loss of one of our principal foundry relationships or assembly services or a delay in foundry or assembly production may result in a material loss of production and revenues
- Obtaining access to manufacturing capacity at semiconductor manufacturing plants may become increasingly difficult and could result in higher costs and a material loss of revenues
- We currently depend on a few customers for a substantial portion of our revenues, and the loss of one or more of these customers may result in a material decline in our revenues
- Perceived health risks relating to cellular handsets could lead to decreased demand for ASICs
- Our business, financial condition and reputation may be materially adversely affected if our ASICs, or the electronic systems of which they are a part, contain defects that cause damage or injury
- Our products are difficult to manufacture and manufacturing defects can adversely affect our results
- We may not be able to remain competitive if we lose any of our key executives or if we cannot hire and retain qualified engineers and sales and marketing personnel
- If we are unable to protect our intellectual property and knowhow from being copied or used by others, our competitors may gain access to its content and technology
- The profitability of our business may be adversely affected by currency fluctuations and by the economic and legal developments in the countries where we conduct our business
- US-resident shareholders may find it more difficult to protect their interests than they would as shareholders of a US-based corporation
- Our future operating results could be materially affected if judgments underlying any of our accounting policies were to significantly change

For more information, see also our annual report on Form 20-F, which we expect to file with the US Securities and Exchange Commission on or about February 20, 2004. In addition, we have identified the following accounting policies and related uncertainties with the accounting measures used in preparing our consolidated financial statements that we believe are essential to understanding the financial reporting risks present in the current economic environment.

### Recoverability of long-lived assets

#### Goodwill

When we acquired our predecessor business, the excess of the purchase price for the acquisition over the fair value of the net assets acquired was recognized as goodwill. At December 31, 2003, the carrying value of our goodwill is €11.8 million. Since 2002, goodwill is no longer amortized, but we have (and will continue) to evaluate the recoverability of our goodwill at least annually (during the third quarter) or when significant events occur or circumstances arise which indicate that the fair value of the Company may be less than its net shareholders' equity. The fair value of the Company is determined by estimating the present value of future cash flows, which we believe is a more appropriate measure to determine fair value than the Company's current market capitalization (which is based on the quoted market price of the Company's ordinary shares). For the year ended December 21, 2003, the expected cash flows were derived from the Company's strategic plan and forecasts. The discount rate applied considered marketplace participant assumptions including a risk-free rate, market risk premium and a beta factor that is consistent with the Company's market peers. If our judgment regarding the recoverability of our goodwill is wrong, if our judgement regarding the appropriateness of measuring the Company's fair value by estimating the present value of future cash flows is wrong, or if our method of determining the discount rate that we applied is wrong, our estimate of the Company's fair value and, therefore, of the carrying value of our goodwill, could be materially incorrect.

#### Other Long-Lived Assets

Our business is capital intensive and has required, and will continue to require, significant investments in long-lived assets, including property, plant, equipment and intangible assets (other than goodwill). At December 31, 2003, the carrying amount of our property, plant and equipment was €20.6 million. As discussed in Note 2 to the consolidated financial statements, recoverability of these long-lived assets that will continue to be held and used is evaluated whenever an indication of impairment exists. Then we will compare the carrying amount of the asset or group of assets to the net undiscounted cash flows expected to be generated by the asset or group of assets. If the asset or group of assets is considered impaired, the impairment recognized is measured as the amount by which the carrying amount of the impaired asset or group of assets exceeds its fair value.

We do not believe that our ability to recover the carrying value of our other long-lived assets has been impaired. However, a general economic downturn and, specifically, a downturn in the semiconductor industry would intensify competitive pricing pressure because of overcapacity in the industry, and we could be forced to decrease production and reduce capacity. Such events could adversely affect our estimates of future net cash flows expected to be generated by our long-lived assets. It is reasonably possible that our future operating results could be materially and adversely affected by an impairment charge related to the recoverability of our long-lived assets.

**Realizable Value of Inventories**

We value inventory at the lower of cost or market. We review the recoverability of inventory based on regular monitoring of the size and composition of the inventory positions, market conditions, current economic events, the pricing environment and projected future demand. This evaluation is inherently judgmental and requires material estimates, including both forecasted product demand and pricing environment, both of which may be susceptible to significant change.

At December 31, 2003, our total inventory was €13.2 million. We believe that our inventory levels are in line with current requirements. However, the demand for our products can fluctuate significantly in response to rapid technological changes in the semiconductor and wireless communications industries. It is reasonably possible that future operating results could be materially and adversely affected if any excess inventory charges are needed.

**Realization of Deferred Tax Assets**

Total net deferred tax assets were €16.2 million at December 31, 2003, and are primarily comprised of deferred tax assets of €24.3 million on tax loss carryforwards, net of a valuation allowance of €12.3 million. While the majority of these losses may be carried forward indefinitely, their realization is dependent on generating sufficient taxable income to utilize the losses. As of December 31, 2003 we recognized a deferred tax asset valuation allowance, to reduce our net deferred tax assets to an expected amount that we believe is more likely than not will be ultimately realized in the future. See Operating and Financial Review – Income Taxes and Note 6 to the consolidated financial statements.

## Outlook

The outlook in the markets addressed by Dialog Semiconductor is positive, and we are well positioned to take advantage of these market opportunities – with our image sensors and camera modules, integrated power management and audio devices, and color display driver chips. The main drivers for growth are expected to be:

- growth in Asia for wireless handsets
- wireless handset growth due to new multimedia, camera, and smart phones
- automotive electronics (safety, engine management and comfort electronics), and industrial lighting systems control

We have already experienced strong growth in Asia during 2003 and expect to see a continuation of the trend in 2004. Much of this growth is driven by exceptional subscriber growth as individual countries aim for more penetration of mobile phone usage: during the second half of 2003, two of the top five cellular handset manufacturers were in Asia.

Camera phones, smart phones and multimedia phones were the big successes of 2003, and most market analysts see them as catalysts for significant worldwide handset sales growth. By 2007, the worldwide mobile phone subscriber base is estimated to reach in excess of 2 billion, hence driving demand for handset sales. In Europe and North America, much of the growth will be from replacement sales, as users turn to adding cameras, colour displays, and audio player capabilities.

Some of the independent market forecasts that support our optimistic outlook are:

- mobile multimedia messaging: large media brands distributing video, photo and animated content, will serve to catalyze MMS usage and drive its revenue growth to \$22 billion by 2008 (source: Strategy Analytics)
- imagers (image sensors): this market will grow to over \$4.0 billion in 2007, which is a combined figure for both CCD and CMOS image sensors, but CMOS is taking a growing share (source: Strategies Unlimited)
- smart phones will grow 94.5% on a compound annual basis through 2007 (source: In-Stat/MDR)
- shipments of handsets with integrated digital camera will grow 64% in 2004, to nearly 100 million units (source: IDC)
- the PDA market will grow to just under 25 million units in 2007, and the newest devices will include wireless as well as higher mega pixel cameras with flash and zoom (source: In-Stat/MDR)
- handset sales will enjoy 8% year-over-year growth in 2004 as shipments of 2.5G and 3G mobile phones accelerate worldwide (source: IDC)
- global demand for automotive electronics systems forecast to reach almost \$150 billion by 2007; the safety and security electronics portion of this figure is \$27 billion (source: Strategy Analytics)

The common thread among these trends is a need for excellent power management circuits to maximize the time between battery charging, and also smarter design techniques for higher levels of integration to ensure both lower power consumption and lower cost. On top of this is a need for high-performance image capture and processing capabilities, at low cost and low power, plus excellent displays.

# Independent Auditors' Report

To the Board of Directors Dialog Semiconductor Plc:

We have audited the accompanying consolidated balance sheets of Dialog Semiconductor Plc and subsidiaries (the "Company") as of December 31, 2003 and 2002 and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dialog Semiconductor Plc and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for goodwill and intangible assets in 2002 and its method of accounting for derivative financial instruments and hedging activities in 2001.

Stuttgart, February 17, 2004

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Helwig	Kiechle
Wirtschaftsprüfer	Wirtschaftsprüfer

# Consolidated Financial Statements

## Consolidated Statements of Operations

(in thousands, except per share data)		Year ended December 31,			
		Notes	2003	2003	2002
Revenues	19	\$ 117,017	€ 92,893	€ 77,104	€ 100,519
Cost of sales	9	(78,572)	(62,374)	(57,409)	(80,574)
<b>Gross margin</b>		<b>38,445</b>	<b>30,519</b>	<b>19,695</b>	<b>19,945</b>
Selling and marketing expenses		(5,287)	(4,197)	(4,149)	(4,054)
General and administrative expense		(6,354)	(5,044)	(6,447)	(5,569)
Research and development		(38,534)	(30,590)	(34,530)	(31,256)
Amortization of goodwill and intangible assets		(2,611)	(2,073)	(1,975)	(3,202)
Restructuring and related impairment charges	3	(2,317)	(1,839)	–	–
<b>Operating loss</b>		<b>(16,658)</b>	<b>(13,224)</b>	<b>(27,406)</b>	<b>(24,136)</b>
Interest income, net		954	757	1,121	898
Foreign currency exchange gains and losses, net	4	(572)	(454)	(1,918)	1,713
Recovery (write-down) of investment	5	397	315	11,969	(42,405)
<b>Result before income taxes</b>		<b>(15,879)</b>	<b>(12,606)</b>	<b>(16,234)</b>	<b>(63,930)</b>
Income tax (expense) benefit	4, 6	(9,843)	(7,814)	6,026	22,544
<b>Net loss</b>		<b>(25,722)</b>	<b>(20,420)</b>	<b>(10,208)</b>	<b>(41,386)</b>
<b>Loss per share:</b>					
Basic and diluted		(0.58)	(0.46)	(0.23)	(0.94)
<b>Weighted average number of shares (in thousands):</b>					
Basic and diluted		43,951	43,951	43,888	43,788



## Consolidated Balance Sheets

(in thousands)	Notes	At December 31,		
		2003	2003	2002
<b>ASSETS</b>				
Cash and cash equivalents		\$ 10,215	€ 8,109	€ 31,005
Trade accounts receivable, net	8	18,062	14,338	16,034
Inventories	9	16,681	13,242	14,507
Marketable securities	10	56,561	44,900	–
Deferred taxes	6	130	103	264
Prepaid expenses	4, 11	2,684	2,131	7,482
Other current assets		1,251	993	2,971
<b>Total current assets</b>		<b>105,584</b>	<b>83,816</b>	<b>72,263</b>
Property, plant and equipment, net	12	25,937	20,590	27,801
Intangible assets	13	6,853	5,440	6,922
Goodwill	12	14,847	11,786	11,786
Deposits	11	231	183	19,390
Deferred taxes	6	22,333	17,729	26,818
Prepaid expenses	4, 11	1,168	927	1,093
<b>TOTAL ASSETS</b>		<b>176,953</b>	<b>140,471</b>	<b>166,073</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
Trade accounts payable		9,016	7,157	10,020
Accrued expenses	14	3,987	3,165	3,669
Income taxes payable		23	18	174
Deferred taxes	4, 6	5	4	162
Other current liabilities		2,034	1,615	2,156
<b>Total current liabilities</b>		<b>15,065</b>	<b>11,959</b>	<b>16,181</b>
Deferred taxes	6	2,102	1,669	2,397
<b>Total liabilities</b>		<b>17,167</b>	<b>13,628</b>	<b>18,578</b>
Ordinary Shares	15	8,487	6,737	6,737
Additional paid-in capital		212,631	168,795	168,781
Accumulated deficit	4	(60,061)	(47,679)	(27,259)
Accumulated other comprehensive loss		(1,238)	(984)	(715)
Employee stock purchase plan shares		(33)	(26)	(49)
<b>Net Shareholders' equity</b>		<b>159,786</b>	<b>126,843</b>	<b>147,495</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>176,953</b>	<b>140,471</b>	<b>166,073</b>

## Consolidated Statements of Cash Flows

(in thousands)	Year ended December 31,			
	2003	2003	2002	2001
<b>Cash flows from operating activities:</b>				
Net loss	\$ (25,723)	€ (20,420)	€ (10,208)	€ (41,386)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:				
Write-down (recovery) of investment	(397)	(315)	(11,969)	42,405
Provision for excess inventory	–	–	1,930	10,689
Restructuring and related impairment charges	772	613	–	–
Depreciation of property, plant and equipment	15,803	12,545	12,834	12,801
Amortization of goodwill and intangible assets	2,611	2,073	1,975	3,202
Losses on disposals of fixed assets	319	253	–	–
Increase in deferred tax asset valuation allowance	12,896	10,237	–	517
Other changes in deferred taxes	(2,500)	(1,984)	(4,167)	(23,831)
Changes in current assets and liabilities:				
Trade accounts receivable	2,130	1,691	450	25,597
Inventories	1,594	1,265	715	8,975
Prepaid expenses	6,780	5,382	1,663	3,683
Trade accounts payable	(3,585)	(2,846)	1,760	(18,525)
Accrued expenses	(325)	(258)	(1,381)	(2,815)
Income taxes payable	(135)	(107)	(1,224)	(7,013)
Other assets and liabilities	(681)	(541)	26	840
<b>Cash provided by (used for) operating activities</b>	<b>9,559</b>	<b>7,588</b>	<b>(7,596)</b>	<b>15,139</b>
<b>Cash flows from investing activities:</b>				
Recovery of investment	397	315	11,969	–
Purchases of property, plant and equipment	(7,433)	(5,901)	(3,872)	(3,157)
Purchases of intangible assets	(1,776)	(1,410)	(2,101)	(577)
Purchases of marketable securities	(56,684)	(44,998)	–	–
Investments and deposits received (made)	27,297	21,670	94	(8,894)
<b>Cash provided by (used for) investing activities</b>	<b>(38,199)</b>	<b>(30,324)</b>	<b>6,090</b>	<b>(12,628)</b>
<b>Cash flows from financing activities:</b>				
Sale of employee stock purchase plan shares	47	37	58	69
Other	–	–	(44)	(6)
<b>Cash provided by financing activities</b>	<b>47</b>	<b>37</b>	<b>14</b>	<b>63</b>
<b>Cash provided by (used for) operating, investing and financing activities</b>	<b>(28,593)</b>	<b>(22,699)</b>	<b>(1,492)</b>	<b>2,574</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(249)	(197)	(129)	173
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(28,842)</b>	<b>(22,896)</b>	<b>(1,621)</b>	<b>2,747</b>
Cash and cash equivalents at beginning of period	39,057	31,005	32,626	29,879
<b>Cash and cash equivalents at end of period</b>	<b>10,215</b>	<b>8,109</b>	<b>31,005</b>	<b>32,626</b>

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

## Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

(in thousands of €)	Ordinary Shares	Additional paid-in capital	Retained earnings (accumulated deficit)	Accumulated other comprehensive loss			stock purchase plan shares	Total
				Currency translation adjustment	Available for sale securities	Derivative financial instruments		
<b>Balance at December 31, 2000</b>	<b>6,737</b>	<b>168,776</b>	<b>24,335</b>	<b>(440)</b>	<b>–</b>	<b>–</b>	<b>(121)</b>	
Net loss	–	–	(41,386)	–	–	–	–	(41,386)
Other comprehensive income (loss)	–	–	–	170	–	(42)	–	128
<b>Total comprehensive loss</b>								<b>(41,258)</b>
Cost of issuance of shares in 2000	–	(6)	–	–	–	–	–	(6)
Sale of employee stock purchase plan shares	–	18	–	–	–	–	51	69
<b>Balance at December 31, 2001</b>	<b>6,737</b>	<b>168,788</b>	<b>(17,051)</b>	<b>(270)</b>	<b>–</b>	<b>(42)</b>	<b>(70)</b>	<b>158,092</b>
Net loss	–	–	(10,208)	–	–	–	–	(10,208)
Other comprehensive loss	–	–	–	(287)	–	(116)	–	(403)
<b>Total comprehensive loss</b>								<b>(10,611)</b>
Cost of issuance of shares in 2000	–	(44)	–	–	–	–	–	(44)
Sale of employee stock purchase plan shares	–	37	–	–	–	–	21	58
<b>Balance at December 31, 2002</b>	<b>6,737</b>	<b>168,781</b>	<b>(27,259)</b>	<b>(557)</b>	<b>–</b>	<b>(158)</b>	<b>(49)</b>	<b>147,495</b>
Net loss	–	–	(20,420)	–	–	–	–	(20,420)
Other comprehensive income (loss)	–	–	–	(366)	(61)	158	–	(269)
<b>Total comprehensive loss</b>								<b>(20,689)</b>
Sale of employee stock purchase plan shares	–	14	–	–	–	–	23	37
<b>Balance at December 31, 2003</b>	<b>6,737</b>	<b>168,795</b>	<b>(47,679)</b>	<b>(923)</b>	<b>(61)</b>	<b>–</b>	<b>(26)</b>	<b>126,843</b>

## Consolidated Fixed Assets Schedule

	Acquisition costs					Balance at December 31, 2003
	Balance at January 1, 2003	Currency change	Additions	Reclassifications	Disposals	
Test equipment	50,283	(17)	3,190	10	(416)	53,050
Leasehold improvements	1,710	(82)	15	–	(740)	903
Office and other equipment	14,048	(431)	2,429	(10)	(1,733)	14,303
Advance payment relating to test equipment	–	–	267	–	–	267
<b>Property, plant and equipment</b>	<b>66,041</b>	<b>(530)</b>	<b>5,901</b>	<b>–</b>	<b>(2,889)</b>	<b>68,523</b>
Software, licenses and other	10,450	(133)	618	–	(5)	10,930
Patents	3,008	–	–	–	–	3,008
<b>Intangible assets</b>	<b>13,458</b>	<b>(133)</b>	<b>618</b>	<b>–</b>	<b>(5)</b>	<b>13,938</b>
<b>Goodwill</b>	<b>15,736</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>15,736</b>
<b>Deposits</b>	<b>19,390</b>	<b>(15)</b>	<b>–</b>	<b>–</b>	<b>(19,192)</b>	<b>183</b>

## Investments in affiliated companies

Name	Registered Office	Participation
Dialog Semiconductor GmbH	Kirchheim/Teck - Nabern, Germany	100 %
Dialog Semiconductor (UK) Limited	Swindon, UK	100 %
Dialog Semiconductor Inc	Clinton, New Jersey, USA	100 %
Dialog Semiconductor KK	Tokyo, Japan	100 %

## Consolidated Fixed Assets Schedule - continued

Depreciation/Amortization					Book value	
Balance at January 1, 2003	Currency change	Additions	Disposals	Balance at December 31, 2003	Balance at December 31, 2003	Balance at December 31, 2002
27,495	(13)	9,892	(418)	36,956	16,094	22,788
1,053	(38)	215	(680)	550	353	657
9,692	(323)	2,504	(1,446)	10,427	3,876	4,356
–	–	–	–	–	267	–
<b>38,240</b>	<b>(374)</b>	<b>12,611</b>	<b>(2,544)</b>	<b>47,933</b>	<b>20,590</b>	<b>27,801</b>
6,367	(106)	1,736	(5)	7,992	2,938	4,083
169	–	337	–	506	2,502	2,839
<b>6,536</b>	<b>(106)</b>	<b>2,073</b>	<b>(5)</b>	<b>8,498</b>	<b>5,440</b>	<b>6,922</b>
<b>3,950</b>	–	–	–	<b>3,950</b>	<b>11,786</b>	<b>11,786</b>
–	–	–	–	–	<b>183</b>	<b>19,390</b>

## Notes to the Consolidated Financial Statements

(In thousands of €, unless otherwise stated)

### 1. General

#### a) Description of Business

Dialog Semiconductor Plc and subsidiaries ("Dialog" or the "Company") is a fabless semiconductor company that develops and supplies power management, audio and imaging technology, delivering innovative mixed signal standard products as well as application specific IC solutions for wireless, automotive and industrial applications. The company's expertise in mixed signal design, with products manufactured entirely in CMOS technology, enhances the performance and features of wireless, hand-held and portable electronic products. Its technology is also used in intelligent control circuits in automotive and industrial applications. Production of these designs is then outsourced, and the final products are returned to Dialog for approval and testing before delivery to the customers.

#### b) Vulnerability Due to Certain Significant Concentrations

The Company's future results of operations involve a number of risks and uncertainties. Factors that could affect the Company's future operating results and cause actual results to vary materially from historical results include, but are not limited to, the highly cyclical nature of both the semiconductor and wireless communications industries, dependence on certain customers and the ability to obtain adequate supply of sub-micron wafers.

The Company's products are generally utilized in the cellular communications and automotive industries. The Company generates a substantial portion of its revenue from the wireless communications market, which accounted for 75%, 71% and 77% of the Company's total revenue for the years ended December 31, 2003, 2002 and 2001, respectively.

The Company's revenue base is diversified by geographic region and by individual customer. Changes in foreign currency exchange rates influence the Company's results of operations. The Company's sales are primarily denominated in Euros and US dollars whereas purchases of raw materials and manufacturing services are primarily denominated in US dollars (see Note 18 for a description of the Company's hedging activities). The Company also has foreign currency exchange risks with respect to its net investments in foreign subsidiaries in Japan, the United Kingdom and the United States. Fluctuations in these currencies could significantly impact the Company's reported results from operations.

The Company depends on a relatively small number of customers for a substantial portion of its revenues, and the loss of one or more of these customers may result in a significant decline in future revenue. During 2003, one customer individually accounted for more than 10% of the Company's revenue. Total revenue from this customer was €60,192 or 65%. During 2002 and 2001, two customers individually accounted for more than 10% of the Company's revenues. Total revenues from these two customers were €46,746 and €67,139 or 61% and 67% in 2002 and 2001, respectively. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers.

**c) Basis of Presentation**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). All amounts herein are shown in thousands of Euro ("€") and for the year 2003 are also presented in U.S. Dollars ("\$"), the latter being unaudited and presented solely for convenience of the reader at the rate of €1 = \$1.2597, the Noon Buying Rate of the Federal Reserve Bank of New York on December 31, 2003. Certain prior year balances have been reclassified to conform with current year presentation.

**2. Summary of Significant Accounting Policies****Principles of Consolidation**

The consolidated financial statements include Dialog Semiconductor Plc and all of its owned subsidiaries. All intercompany accounts and transactions are eliminated in consolidation.

**Cash and Cash Equivalents**

Cash and cash equivalents include highly liquid investments with original maturity dates of three months or less.

**Marketable Securities**

Marketable securities at December 31, 2003 consists of debt securities that are classified as available-for-sale and are recorded at fair value as determined by the most recently quoted market price of each security at the balance sheet date. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a component of other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary will result in an impairment, which is charged to earnings. Interest income is recognized when earned.

**Inventories**

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

**Trade Accounts Receivable**

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts quarterly. Management, considering current information and events regarding the customers' ability to repay their obligations, considers the collectibility of a trade account receivable to be impaired when it is probable that the Company will be unable to collect all amounts due according to the sales terms. When a trade receivable is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows. Any impairment losses are included in the allowance for doubtful accounts through a charge to bad debt expense. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Recoveries of trade receivables previously written-off are recorded when received. The Company does not have any off-balance-sheet credit exposure related to its customers.

#### Other Current Assets

Other current assets include tax refunds receivable and interest receivable at December 31, 2003 and 2002. It also included the fair value of a forward foreign currency contract at December 31, 2002, which was settled in 2003 (see Note 18).

#### Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation.

Depreciation is charged on a straight-line basis over the estimated useful lives of the assets as follows:

Equipment	Useful life
Test equipment	3 to 5 years
Leasehold improvements	Shorter of useful life or lease term
Office and other equipment	3 to 13 years

#### Leasing

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

#### Goodwill and other Intangible Assets

Goodwill represents the excess of purchase price over fair value of net assets of businesses acquired. Purchased intangible assets with estimable useful lives primarily consist of licenses, software, customer lists and patents and are recorded at acquisition cost less accumulated amortization. Intangible assets are amortized on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 17 years. On January 1, 2002 the Company adopted SFAS 142, *Goodwill and Intangible Assets*. SFAS 142 requires that goodwill and certain intangibles no longer be amortized, but instead tested for impairment at transition and at least annually. SFAS 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

In connection with SFAS 142's transitional goodwill impairment evaluation, the Company evaluated its existing intangible assets and goodwill and determined that an amount of € 383 (net of accumulated amortization) for assembled workforce, previously included in intangible assets, was required to be reclassified into goodwill in order to comply with SFAS 142. The Company also reassessed the useful lives and residual values of all intangible assets and determined that amortization period adjustments were not necessary and that none of its intangible assets have indefinite useful lives. Further the Company performed a transitional assessment and determined that its ability to recover the carrying value of its recorded goodwill was not impaired as of January 1, 2002.

Goodwill is tested annually for impairment and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent the carrying amount exceeds the asset's fair value. Prior to the adoption of SFAS 142, goodwill and assembled workforce were amortized over their estimated useful



life. Amortization expense related to goodwill and assembled workforce was €1,361 for the year ended December 31, 2001. The following table reconciles previously reported net loss as if the provisions of SFAS 142 were in effect in 2001:

	Year ended December, 31 2001
<b>Net loss</b>	
As reported	(41,386)
Pro forma	(40,025)
Basic loss per share	
As reported	(0.94)
Pro forma	(0.91)
Diluted loss per share	
As reported	(0.94)
Pro forma	(0.91)

#### Impairment of Long-Lived Assets

The Company adopted SFAS 144 on January 1, 2002. The adoption of SFAS 144 did not affect the Company's financial statements. In accordance with SFAS 144, long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset or group of assets to future undiscounted net cash flows expected to be generated by the asset or group of assets. If the carrying amount of an asset or group of asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Prior to the adoption of SFAS 144, the Company accounted for its long-lived assets in accordance with SFAS 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*.

#### Foreign Currencies

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

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

Currency	Exchange rate at December 31,		Annual average exchange rate		
	2003 € 1 =	2002 € 1 =	2003 € 1 =	2002 € 1 =	2001 € 1 =
Great Britain	0.70	0.65	0.69	0.63	0.62
Japan	133.68	124.19	130.93	118.05	108.76
United States	1.25	1.04	1.13	0.94	0.90
Sweden	9.07	9.15	9.12	9.16	9.25

### Revenue Recognition

Substantially all of the Company's revenue is derived from the sale of its products. Product revenue, net of discounts, is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price of the transaction is fixed and determinable, and collectibility is reasonably assured. Service revenue, which is derived from research and development reimbursement projects, is recognized when services have been rendered based upon the acceptance by a customer of project milestones.

### Product-Related Expenses

Cost of sales consist of the costs of outsourcing production and assembly, personnel costs and applicable overhead and depreciation of test and other equipment. Provisions for estimated product warranty are recorded in cost of sales at the time the related sale is recognized. Expenditures for advertising and sales promotion and for other sales-related expenses are charged to marketing expenses as incurred. Shipping and handling costs amounting to €251 (2002: €221; 2001: €241) are recorded within selling expenses.

### Research and Development

Research and development costs are generally expensed as incurred and amounted to €30,590 (2002: €34,530; 2001: €31,256). Research and development costs incurred in connection with customer service contracts are capitalized and then charged to cost of sales when the related service revenue is recognized. Research and development costs charged to customers and included in cost of sales, amounted to approximately to €263 (2002: €987; 2001: €2,683).

### Income Taxes

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

### Stock-Based Compensation

The Company has a stock-based employee compensation plan that is accounted for using the intrinsic-value-based method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Under this method, no stock-based compensation cost is reflected in net income (loss), as all options granted by the plan had an exercise price equal to market value of the underlying common stock on the date of grant. SFAS 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation. As allowed by SFAS 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS 123, as amended by SFAS 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

	Year ended December 31,		
	2003	2002	2001
Net loss, as reported:	(20,420)	(10,208)	(41,386)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(601)	(1,166)	(1,123)
<b>Pro forma net loss</b>	<b>(21,021)</b>	<b>(11,374)</b>	<b>(42,509)</b>
Earnings (loss) per share			
Basic – as reported	(0.46)	(0.23)	(0.94)
Basic – pro forma	(0.48)	(0.26)	(0.97)
Diluted – as reported	(0.46)	(0.23)	(0.94)
Diluted – pro forma	(0.48)	(0.26)	(0.97)

### Derivative Instruments and Hedging Activities

On January 1, 2001, the Company adopted SFAS 133, *Accounting for Derivative Instruments and Certain Hedging Activities* and SFAS 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS 133*. SFAS 133 and SFAS 138 require that all derivative instruments be recorded on the balance sheet at their respective fair values, regardless of the purpose for holding them. Changes in the fair value of derivative financial instruments are recognized periodically either in income or, in the case of a cash flow hedge, in shareholders' equity (as a component of other comprehensive income). In situations where the derivative financial instrument does not qualify for hedge accounting, the Company carries the derivative instrument at its fair value on the balance sheet and recognizes any subsequent changes in fair value in earnings.

In accordance with the transition provisions of SFAS 133, the Company recorded a net transition gain of €605 (net of income tax expense of €340) in accumulated other comprehensive income (loss). During 2001, the Company also reclassified €647 (net of income tax expense of €364) from accumulated other comprehensive income to net loss relating to the transition adjustment recorded at January 1, 2001.

### Earnings (Loss) per Share

Earnings (loss) per share has been computed using the weighted average number of outstanding ordinary shares for each year. Because the Company reported a net loss in each of the years in the three-year period ended December 31, 2003, only basic per share amounts have been presented for those years. Had the Company reported net income in 2003, 2002 and 2001, the weighted average number of shares outstanding would have potentially been diluted by 962,184, 2,634,382 and 2,672,506 stock options, respectively (not assuming the effects of applying the treasury stock method).

### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and judgments include the recoverability of the carrying value of goodwill and other long-lived assets, the realizability of deferred income tax assets and inventories, and the fair value of stock-based employee compensation awards. Actual results may differ from those estimates.

### Recently Issued Accounting Standards

In December 2003, the FASB issued Interpretation No. 46, (revised December 2003), *Consolidation of Variable Interest Entities*, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. The Company does not currently have any involvement with variable interest entities. Therefore, the initial adoption of the Interpretation did not have and will not have any impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The provisions of SFAS 146 were effective for exit or disposal activities initiated after December 31, 2002. The Company decided to close its Swedish subsidiary in the first quarter of 2003 and a portion of this restructuring plan is being accounted for pursuant to SFAS 146 (see Note 3).

### 3. Restructuring and Related Impairment Charges

Restructuring and related asset impairment charges are comprised of €1,554 restructuring charges and €285 impairment charges totaling €1,839 for the year ended December 31, 2003.

#### a) Restructuring Charges

In the first quarter of 2003 the Company decided to close its Swedish subsidiary. Restructuring charges include contractual termination benefits that were paid to 39 employees affected by the closing (€1,076) and a provision for estimated costs that will continue to be incurred under an executory contract for its remaining term without economic benefit to the Company (€478). The contractual termination benefits were accounted for in accordance with SFAS 88. This provision for costs that will continue to be incurred for the duration of the executory contract is recorded at its estimated fair value in accordance with SFAS 146.

The pretax amounts for the restructuring charges are comprised of the following:

	Employee termination costs	Contract termination costs	Total
Liability balance at January 1, 2003	–	–	–
Initial charges	834	346	1,180
Additional charges	242	132	374
Payments made	(1,076)	(150)	(1,226)
<b>Liability balance at December 31, 2003</b>	<b>–</b>	<b>328</b>	<b>328</b>

#### b) Asset Impairment Charges

As a result of the closure of the Swedish facility, certain long-lived assets with a net carrying value of €158 have been abandoned and certain prepaid expenses of €127 no longer provided any future benefit to the Company. Accordingly, impairment charges totaling €285 have been recognized for the year ended December 31, 2003, to write-off these assets.

#### 4. Foreign currency exchange gains and losses, net

Foreign currency transaction gains and losses result from amounts ultimately realized upon settlement of foreign currency transactions and from the period end re-measurement of foreign currency denominated monetary assets and liabilities into the functional currency of the respective entity. The Company has made advance payments for future wafer deliveries to silicon suppliers. Such advance payments are classified in the balance sheet line items "Prepaid expenses." The outstanding balance of the advance payments are refunded in proportion to the Company's purchases of wafers. Such advances were previously treated similar to inventory and therefore considered as a non-monetary asset in the re-measurement process. In the second quarter of 2003, management determined that it was appropriate to treat these advance payments as "monetary assets" for purposes of re-measurement into Euro, with the resulting exchange gains or losses recorded in the statements of operations. Accordingly, certain prior period amounts presented have been revised to reflect this re-measurement process. Management believes that the impact of this re-measurement using the then current exchange rates applicable for those periods impacted (rather than the historical exchange rate at the time the Company entered into the relevant contracts) does not have a material effect on any financial statements previously issued.

#### 5. Recovery (Write-down) of Investment

In the fourth quarter of 2001, the Company determined that its ability to recover the full amount of its investments in silicon supplier ESM was impaired. Accordingly the Company wrote off the investments in ESM. In March 2002, ESM was acquired by International Rectifier. As a result, the Company was able to subsequently recover €12.0 million and €0.3 million of its total investment in ESM in 2002 and 2003.

## 6. Income Taxes

Income (loss) before income taxes consists of the following:

	Year ended December 31,		
	2003	2002	2001
Germany	(6,323)	(11,376)	(69,159)
Foreign	(6,283)	(4,858)	5,229
	<b>(12,606)</b>	<b>(16,234)</b>	<b>(63,930)</b>

The benefit (provision) for income taxes consists of the following:

	Year ended December 31,		
	2003	2002	2001
<b>Current taxes:</b>			
Germany	250	43	856
Foreign	(91)	1,685	(1,618)
<b>Deferred taxes:</b>			
Germany	(8,287)	3,941	23,737
Foreign	314	357	(431)
	<b>(7,814)</b>	<b>6,026</b>	<b>22,544</b>

Although Dialog is a UK company, its principal operations are located in Germany and all of its operating subsidiaries are owned by its German subsidiary. Accordingly, the following information is based on German corporate tax law. The Company's statutory tax rate for its German subsidiary is 25%. Including the impact of the solidarity surcharge of 5.5%, the federal corporate tax rate amounts to 26.375%.

A reconciliation of income taxes determined using the German corporate tax rate of 26.375% plus the after federal tax benefit rate for trade taxes of 11.225%, for a combined statutory rate of 37.6%, is as follows:

	Year ended December 31,		
	2003	2002	2001
Expected benefit (provision) for income taxes	4,740	6,104	24,037
Foreign tax rate differential	(505)	(387)	395
Amortization of non-deductible goodwill and intangible assets	(41)	(41)	(494)
Write-down of investment	—	—	(1,163)
Valuation allowance on deferred tax assets	(11,804)	(118)	(560)
Others	(204)	468	329
<b>Actual (expense) benefit for income taxes</b>	<b>(7,814)</b>	<b>6,026</b>	<b>22,544</b>

Deferred income tax assets and liabilities are summarized as follows:

	At December 31,	
	2003	2002
Property, plant and equipment	196	219
Net operating loss and tax credit carryforwards	24,284	27,400
Liabilities	5,640	—
Other	41	94
Valuation allowance	(12,329)	(631)
<b>Deferred tax assets</b>	<b>17,832</b>	<b>27,082</b>
Property, plant and equipment	(1,669)	(2,397)
Receivables	(4)	(38)
Liabilities	—	(124)
<b>Deferred tax liabilities</b>	<b>(1,673)</b>	<b>(2,559)</b>
<b>Net deferred tax assets (liabilities)</b>	<b>16,159</b>	<b>24,523</b>

At December 31, 2003, the Company has net operating loss carryforwards for federal income tax purposes in Germany of €61,696 which are available to offset future federal taxable income, if any, and have no expiration date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In December 2003, the German government enacted new tax legislation, which among other things, limits the use of German tax-loss carryforwards to 60% of the taxable income for fiscal years starting from 2004 and thereafter. As a result of this change in tax law, the Company has re-evaluated its deferred tax asset position and the need for a valuation allowance. The assessment requires the exercise of judgment on the part of management, with respect to, among other things, benefits that could be realized from available tax strategies and future taxable income, as well as other positive and negative factors. The assessment considered the weight given to cumulative losses incurred in Germany over the three-year period ended December 31, 2003, as well as detailed forecasts of taxable income in the foreseeable future. Although the Company forecasts generating future taxable income to approximate available tax-loss carryforwards, the change in tax law increases the forecasted number of additional years that future taxable income must be generated in order to fully realize these loss carryforward benefits. Pursuant to SFAS 109 and the inherent uncertainties in projecting future taxable income, management has concluded that it is more likely than not that a portion of our tax losses may not ultimately be realized. Consequently, the Company recognized an additional valuation allowance as of December 31, 2003 of €11,804, to reduce the carrying value of its net deferred tax assets to an amount that is more likely than not expected to be ultimately realized.

## 7. Additional Cash Flow Information

The following represents supplemental information with respect to cash flows:

	Year ended December 31,		
	2003	2002	2001
Interest paid, net	14	9	83
Income taxes paid, net	372	911	7,622

## 8. Trade Accounts Receivable, net

The recorded trade accounts receivable for which an impairment has been recognized and the related allowance for doubtful accounts at December 31, 2003 and 2002 were €270 and €197, and €616 and €397, respectively.

The allowance for doubtful accounts developed as follows:

	Year ended December 31,		
	2003	2002	2001
Allowance for doubtful accounts at beginning of year	397	439	1,036
Additions charged to bad debt expense	230	222	9
Write-offs charged against the allowance	(210)	(139)	(189)
Reductions charged to bad debt expense	(220)	(125)	(417)
<b>Allowance for doubtful accounts at end of year</b>	<b>197</b>	<b>397</b>	<b>439</b>

## 9. Inventories

Inventories are comprised of the following:

	At December 31,	
	2003	2002
Raw materials	2,738	5,346
Work-in-process	5,026	5,131
Finished goods	5,478	4,030
	<b>13,242</b>	<b>14,507</b>

Cost of sales includes a provision for excess inventory of €1,930 and €10,689 for the years ended December 31, 2002 and 2001, respectively.

## 10. Marketable Securities

During the year ended December 31, 2003, the Company acquired debt securities with a maturity between four to seven months, which are classified as available for sale, for a total purchase price of €44,998. The aggregate costs, fair values, unrealized gains and losses per security class are as follows.

	Year ended December 31, 2003			
	Cost	Fair value	Gain	Loss
Debt securities	44,998	44,900	—	(98)



### 11. Deposits and Prepaid Expenses

At December 31, 2002, the Company maintained deposits of \$20 million with Chartered Semiconductor Manufacturing Pte., Ltd. ("Chartered"). These deposits were refunded to the Company in October 2003. In addition, the Company paid Chartered a total of \$10 million in 2000 as an advance payment for future wafer deliveries and \$2.5 million to another supplier. Such advance payments are classified in the balance sheet line items "Prepaid expenses". The outstanding balance of the advance payments is refunded in proportion to the Company's purchases of wafers from these suppliers, and at this time, the Company expects to have the entire advance payments refunded. The amount of advance payments classified in Prepaid expenses on the consolidated balance sheet as current assets represents that the amount of advance payments expected to be refunded in the next twelve months.

### 12. Other long-term assets

Information with respect to changes to the company's property, plant and equipment, net, intangible assets, goodwill, investments and deposits is presented in the consolidated Fixed Asset Schedule included herein.

Depreciation expense amounted to €12,611, €12,834 and €12,801 for the years ended December 31, 2003, 2002 and 2001, respectively.

### 13. Intangible assets

During the year ended December 31, 2003, the Company acquired software and licenses for a total purchase price of €618. The expected weighted average useful life of these assets is 3 years. During the year ended December 31, 2002, the Company acquired the CMOS imaging technology and associated CMOS Active Pixel Sensor (APS) patent portfolio from Sarnoff Corporation, a research and development institute, for a total purchase price of €3,008. The expected weighted average useful life of these patents is 9 years. Installment payments of, in total, €792 and €1,504 were paid in 2003 and 2002, respectively. A further installment is payable in cash or Company shares in 2004 when certain CMOS imaging sensors ("imagers") have been successfully developed by Sarnoff. In addition, Sarnoff may be paid additional contingent consideration which will be determined as a percentage of the revenues received from sales of imagers used for camera applications and as an agreed sum for each imager used for cellular phone applications. Such contingent consideration is limited in absolute terms and has a fixed expiration date as specified in the purchase agreement.

The aggregate amortization expense for the years ended December 31, 2003, 2002 and 2001 was €2,073, €1,975 and €1,875, respectively. Amortization expense of the gross carrying amount of intangible assets at December 31, 2003 is estimated to be €1,476 in 2004, €935 in 2005, €551 in 2006, €487 in 2007 and €479 in 2008.

#### 14. Accrued Expenses

The Company issues various types of contractual product warranties under which it guarantees the performance of products delivered for a certain period or term. The changes in the provision for those product warranties are summarized as follows:

	At December 31,	
	2003	2002
Balance at beginning of year	115	125
Utilizations	(115)	(105)
Additions	135	95
<b>Balance at end of year</b>	<b>135</b>	<b>115</b>

#### 15. Shareholders' Equity and Comprehensive Income

At December 31, 2003, Dialog had authorized 104,311,860 ordinary shares with a par value of £ 0.10 per share. Issued and outstanding were 44,068,930 ordinary shares.

The related tax effects allocated to each component of other comprehensive income (loss) for the years ended December 31, 2003, 2002 and 2001 are as follows:

	Year ended December 31,								
	2003			2002			2001		
	Pretax	Tax effect	Net	Pretax	Tax effect	Net	Pretax	Tax effect	Net
Unrealized (losses) gains on available for sale securities	(98)	37	(61)	–	–	–	–	–	–
Unrealized (losses) gains on derivative financial instruments	253	(95)	158	(185)	69	(116)	(66)	24	(42)
Currency translation adjustment	(508)	142	(366)	(437)	150	(287)	170	–	170
<b>Other Comprehensive Income (loss)</b>	<b>(353)</b>	<b>84</b>	<b>(269)</b>	<b>(622)</b>	<b>219</b>	<b>(403)</b>	<b>104</b>	<b>24</b>	<b>128</b>

In 2003, realized losses of €44 (net of €27 tax benefits) on the settlement of a derivative financial instrument were reclassified into net loss (see Note 18).

#### 16. Stock-based Compensation

##### a) Stock option plan

On August 7, 1998, the Company adopted a stock option plan ("Plan") under which employees and directors may be granted from time-to-time, at the discretion of the Board, stock options to acquire up to 3,840,990 shares of the Company's authorized but unissued ordinary shares. On May 16, 2002 the shareholders of the Company approved a resolution increasing the maximum amount of stock options which may be granted by the company to 15%, after issue, of the Company's issued share capital. At December 31, 2003, 15%, after issue, of the Company's issued share capital amounted to 7,776,870.

Stock options are granted with an exercise price not less than the estimated fair value at the date of grant. Stock options have terms of ten years and vest over periods of one to five years from the date of grant.

The fair value of all grants in the three-year period ended December 31, 2003 is estimated using the Black-Scholes option pricing model. The following weighted-average assumptions were used for stock option grants for the years ended December 31, 2003, 2002 and 2001.

	Year ended December 31,		
	2003	2002	2001
Expected dividend yield	0%	0%	0%
Expected volatility	74%	106%	108%
Risk free interest rate	3.4%	3.7%	4.6%
Expected life (in years)	3.8	5	2.9
Weighted-average fair value of options granted (in €)	2.21	1.83	4.37

Stock option plan activity for the years ended December 31, 2003, 2002 and 2001 was as follows:

(prices in €)	Year ended December 31,					
	2003		2002		2001	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	2,634,382	3.62	2,672,506	3.78	2,849,778	14.01
Granted	2,050,180	3.37	124,060	2.33	1,193,460	6.86
Exercised	(76,828)	0.52	(79,174)	0.79	(159,006)	0.42
Forfeited	(204,004)	6.21	(83,010)	9.78	(145,106)	20.41
Cancelled	(991,460)	7.29	—	—	(1,066,620)	32.80
<b>Outstanding at end of year</b>	<b>3,412,270</b>	<b>2.32</b>	<b>2,634,382</b>	<b>3.62</b>	<b>2,672,506</b>	<b>3.78</b>
Options exercisable at year end	1,013,356	0.70	1,217,402	3.07	536,594	0.89

In June 2001, the Company's board of directors approved a resolution giving employees the right to cancel their options granted in June and October 2000. Employees elected to cancel a total of 250,040 options granted in June 2000 with an exercise price of €55 and 816,580 options granted in October 2000 with an exercise price of €26. In December 2001, approximately 1.0 million options were granted at an exercise price equal to fair value (at that date) of €7 per share.

In April 2003, the Company's board of directors approved a second resolution giving employees the right to cancel their options granted in 2000, 2001 and 2002. Employees elected to cancel a total of 991,460 options with a weighted average exercise of €7.29. In November 2003, approximately 2.0 million options were granted at an exercise price equal to fair value (at that date) of €3.45 per share.

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2003	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable at December 31, 2003	Weighted-Average Exercise Price
€ 0.32 - 2.15	1,420,630	5.5	0.69	1,000,020	0.62
€ 3.00 - 9.00	1,991,640	9.9	3.47	13,336	6.04
<b>€ 0.32 - 9.00</b>	<b>3,412,270</b>	<b>8.1</b>	<b>2.32</b>	<b>1,013,356</b>	<b>0.70</b>

#### b) Employee Stock Purchase Plan

On March 26, 1998, in connection with the acquisition of the Company, the Company and its then majority owner, Apax Partners, adopted a Subscription and Shareholders Agreement under which employees and directors were invited at the discretion of the Board, to purchase up to 3,456,890 ordinary shares of the Company from Apax Partners or an established Employee Benefit Trust. The purchase price of the shares was equal to their estimated fair value on the date the employee or director subscribes for those shares. During the first quarter of 1999, the Trust acquired the remaining 668,800 ordinary shares from Apax Partners, which were not sold to employees or directors for purposes of distributing them to employees under the Employee Stock Purchase Plan or for distribution in connection with the exercise of employee stock options. At December 31, 2003, the Trust continued to hold 71,981 shares.

### 17. Commitments

The Company leases design software, all of its office facilities, office and test equipment, and vehicles under operating leases. Total rentals under operating leases, charged as an expense in the statement of operations, amounted to €7,581, €7,229 and €8,446 for the years ended December 31, 2003, 2002 and 2001, respectively.

Future minimum lease payments under rental and lease agreements which have initial or remaining terms in excess of one year at December 31, 2003 are as follows:

	2004	2005	2006	2007	2008	Thereafter
Operating leases	8,729	8,140	377	171	167	484

At December 31, 2003, the Company had an unused short-term credit line of €12,782. There are no amounts outstanding under this credit line at December 31, 2003.

### 18. Derivative Financial Instruments and Hedging Activities

#### a) Use of Financial Instruments

The Company's sales are primarily denominated in Euros and US dollars whereas purchases of raw materials and manufacturing services are primarily denominated in US dollars. In order to manage these foreign currency exchange risks, the Company attempts to match cash inflows and outflows (sales with supply costs) in the same currency, primarily the US dollar. In situations where the Company is not able to effectively match cash inflows and outflows in the same currency, management considers the use of

derivative financial instruments. As a matter of policy, the Company does not engage in derivatives trading, derivatives market-making or other speculative activities.

To hedge existing foreign currency exposure related to a \$20 million deposit (see Note 11), the Company purchased foreign currency forward contracts in 2000 to effectively change the US Dollar deposits into Euro (€21.680) upon the expected return of the deposit as of December 31, 2003. These deposits were refunded to the Company in October 2003. Upon receipt of the deposit, the Company settled its currency hedging position related to this deposit and recognized a loss of €71 in the consolidated statement of operations.

In the fourth quarter of 2003, the Company entered into derivative financial arrangements with a bank (the "counterparty") that obligates the Company, if directed to do so by the counterparty, to purchase a total of \$3,611 during the first half of 2004 at euro-dollar exchange rates ranging from 1.22 to 1.24. These arrangements do not qualify for hedge accounting treatment. Accordingly, the fair value of these derivative financial instruments, which are based on a Black-Scholes pricing model, are recognized on the balance sheet and the changes in fair value are recognized in earnings. At December 31, 2003, these transactions resulted in a net unrealized loss of €78 recognized in earnings. The Company does not believe these arrangements will have a material impact on its financial statements.

#### **b ) Fair value of financial instruments**

The fair value of a financial instrument is the price at which one party would assume the rights and /or duties of another party.

The carrying amounts and fair values of the Group's financial instruments are as follows:

	At December 31,			
	2003		2002	
	Carrying amount	Fair Value	Carrying amount	Fair Value
<b>Financial instruments (other than derivative instruments)</b>				
Cash and cash equivalents	8,109	8,109	31,005	31,005
Marketable securities	44,900	44,900	—	—
Deposits	183	183	19,390	19,390
<b>Derivative instruments (currency contracts)</b>				
Current assets	—	—	2,231	2,231
Current liabilities	78	78	—	—

The fair values of the forward foreign currency contracts in 2002 were based on reference exchange rates adjusted for the respective interest rate differentials.

## **19. Segment Reporting**

The Company has one operating segment, which is the design and supply of semiconductor chips. The Company delivers its products to various market sectors and generates a substantial portion of its revenue from the wireless communications market; 75%, 71% and 77% of total revenues in the years ended December 31, 2003, 2002 and 2001, respectively.

Revenues by market sector consisted of the following:

	Year ended December 31,		
	2003	2002	2001
Wireless communication	69,849	54,715	77,751
Automotive	7,896	6,074	5,923
Industrial	12,790	13,732	14,222
Other	2,358	2,583	2,623
	<b>92,893</b>	<b>77,104</b>	<b>100,519</b>

Revenues are allocated to countries based on the location of the shipment destination:

	Year ended December 31,		
	2003	2002	2001
Germany	45,395	31,478	22,912
France	4,532	9,348	5,510
Sweden	206	319	16,169
United Kingdom	1,283	1,397	4,356
Other European countries	8,949	9,982	12,024
China	18,198	13,006	20,084
Malaysia	—	694	7,773
Other countries	14,330	10,880	11,691
	<b>92,893</b>	<b>77,104</b>	<b>100,519</b>

Following are the net carrying values of investments in property, plant and equipment by geographic location:

	At December 31,	
	2003	2002
<b>Property, plant and equipment</b>		
Germany	19,634	25,881
Japan	176	243
United Kingdom	358	683
USA	422	560
Sweden	—	434
	<b>20,590</b>	<b>27,801</b>

## 20. Transactions with Related Parties

Adtran Inc. ("Adtran") holds a substantial ownership interest in the Company. The Company sells components to Adtran in the ordinary course of business. Revenues amounted to €2,343, €2,582 and €2,623, in 2003, 2002 and 2001, respectively. Net receivables due from Adtran were €297 and €306 at December 31, 2003 and 2002, respectively. Timothy Anderson, a member of the Company's Board of Directors, is also a partner in the law firm Reynolds Porter Chamberlain, which frequently acts as the Company's legal adviser. Fees to Reynolds Porter Chamberlain for legal services rendered were €162, €268 and €159 in 2003, 2002 and 2001, respectively.

# Board of Directors

## Report of the Board of Directors

As reported in this document, 2003 was a year of consolidation and preparation for new opportunities from a broadening product and technology portfolio. Collaboration with partners and customers ensured that we made progress in the development of products for a more diverse customer base.

During the year the Board oversaw the functioning of executive management of the Company at the quarterly Board Meetings of February 14, April 16, July 16, October 15, 2003 and assured itself of the proper conduct of executive management during that year. At such Board Meetings the Board received and analyzed reports from the chief executive as to the achievements of the Company as compared to budget and progress made in achieving the commercial goals for the year.

The Compensation Committee, comprising Jan Tufvesson, Michael Glover and Tim Anderson met in November 2003 to discuss the achievements of the Management during that year and to establish the individual objectives of the Management for 2004. The Audit Committee, comprising of Jan Tufvesson and Michael Glover, met on a quarterly basis. These meetings concentrated on a review of the financial information to be reported on for the relevant prior financial period and on the internationally accepted standards for fair and responsible financial reporting and corporate governance.

The Company's audited financial statements, for the year ended December 31, 2002, and the reports from the Directors and Auditors thereon were presented to, and approved by, the shareholders at the annual general meeting of the Company, held on May 15, 2003, at which KPMG, the Company's independent auditor was reappointed until the following annual general meeting of the Company.

The Board extends its thanks and appreciation to the Executive Management and all employees for their hard work and considerable achievements in 2003.

## Corporate Governance

### High corporate governance standards

Dialog Semiconductor Plc is committed to comply with German, US and internationally accepted standards for fair and responsible corporate governance. Accordingly, Dialog Semiconductor (as a foreign Company listed on the German stock exchange) has established and published its own Corporate Governance Principles corresponding in substance to the provision of the "German Declaration on Corporate Governance". Also, in accordance with the Sarbanes-Oxley Act of 2002, Dialog has adopted a Code of Business Conduct and Ethics and maintains an Audit Committee. Furthermore, as Dialog is listed on NASDAQ, the Code of Business Conduct and Ethics complies with NASDAQ's corporate governance rules. Dialog has adopted and will follow these principles and codes in order to further enhance the confidence of shareholders, customers, employees and the general public in the Company.

Full details of the Corporate Governance Principles and the Code of Business Conduct and Ethics are published on Dialog Semiconductor's internet site ([www.dialog-semiconductor.com](http://www.dialog-semiconductor.com)). In summary the Corporate Governance Principles cover the following key areas.

### Shareholders rights and the Annual General Meeting (AGM)

Each share carries one vote, and there are no multiple voting rights or preferential voting rights (golden shares). All financial and independent audit reports are presented to the AGM. The AGM is where the directors will obtain authorization to approve and pass resolutions related to Company business, such as auditor's remuneration, and issue of new shares. The Company will also facilitate the personal exercising of shareholders' voting rights. The company shall publish key information relating to the AGM on its web site on the day of the annual meeting.

### Board of Directors' responsibilities, composition and compensation

Dialog has six non-executive directors and one executive director on the Board, to supervise the general management and develop the Company's strategy. The non-executive directors do not play an active role in day-to-day operations providing an independence and objectivity in the making of key decisions. During 2003, directors received the remuneration listed below and their shareholdings in Dialog Semiconductor are as follows.



Name	Position	Compensation (in €)		Directors Holdings	
		Base salary	Bonus / Long-term incentives	Shares	Options
Roland Pudelko	Executive Director, CEO and President	267,323	—	320,405	517,450
Tim Anderson <sup>1)</sup>	Non-executive Director	7,228	—	36,816	—
Michael Glover	Non-executive Chairman of the Audit Committee	30,717	—	195,000	—
John McMonigall	Non-executive Director	22,285	—	—	—
Gregorio Reyes	Non-executive Director (since December 1, 2003)	3,614	—	10,000	—
Michael Risman	Non-executive Director	22,285	—	1,172	—
Jan Tufvesson	Non-executive Chairman	30,717	—	175,062	—
Tord Wingren	Non-executive Director (until April 11, 2003)	1,807	—	—	—
		<b>385,976</b>	<b>—</b>	<b>738,455</b>	<b>517,450</b>

1) Tim Anderson is also a partner in the law firm Reynolds Porter Chamberlain, which frequently acts as our legal adviser. Fees to Reynolds Porter Chamberlain for legal services rendered during the 2003 fiscal year amounted to €162.

Variable compensation of the Chief Executive Officer is measured based on the profitability of the Company as well as success in reaching specific strategic goals.

#### Audit Committee and Compensation Committee

Dialog has established an Audit Committee of the Board of Directors consisting of independent directors: Messrs. Glover (chairman of the Audit Committee) and Tufvesson. To maintain independence, members of the Committee are not to receive payment from the Company for consulting, advisory, or other services other than for board service and are not to be affiliated with the Company. The Compensation Committee determines the salaries and incentive compensation of Dialog's officers and the officers of the Company's subsidiaries and provides recommendations for the salaries and incentive compensation of other employees and consultants. Our Compensation Committee consists of Messrs. Tufvesson (chairman of the Compensation Committee), Glover and Anderson. None of the members of this Committee should serve as an employee of the Company.

#### Transparency, including director's dealing, insider dealing and loans

Dialog promptly discloses price sensitive information to the stock exchanges and then publishes the information electronically. Significant shareholder interests should be reported to the Company according to the UK Companies Act 1985. Transactions in securities of the Company's own shares carried out by members of the Board of Directors and of their family members will be reported and published without delay pursuant to section 15a of the German Securities Trading Act (Wertpapierhandelsgesetz). With regard to insider dealing Dialog has adopted a Code of Dealing, in which we comply with stringent guidelines to ensure against suspicion of abusing the possession of price sensitive information, by prohibiting dealing in any of the company's financial instruments during defined periods. In addition, the Company will not provide or guarantee any loans to directors or senior executives.

#### Business conduct and ethics

The Company shall comply with all governmental laws, rules and regulations that are applicable to the Company's activities, and expects that all directors, officers and

employees acting on behalf of the Company will obey the law. Directors, officers and employees should not be involved in any activity which creates or gives the appearance of a conflict of interest between their personal interests and the Company's interests. The Company is committed to promoting the values of honesty, integrity and fairness in the conduct of its business and sustaining a work environment that fosters mutual respect, openness and individual integrity. Directors, officers and employees are expected to deal honestly and fairly with the Company's customers, suppliers, competitors and other third parties.

#### Auditor's independence

The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of annual financial statements or services by the principal accountant, KPMG, were as follows:

(in thousands of €)	Year ended December 31,	
	2003	2002
Audit fees	169	161
Tax fees	65	100
	<b>234</b>	<b>261</b>

Tax services rendered in 2003 were pre-approved by the audit committee in accordance with § 401(i) of the Sarbanes – Oxley Act of 2002.

Our Auditor, KPMG, confirmed their independence at each quarterly audit committee meeting and declared the following:

“We hereby confirm, that as of February 17, 2004, we are independent accountants with respect to the Company within in the meaning of the Securities Acts administered by the Securities and Exchange Commission of the United States and the requirements of the Independence Standards Board, German law, the German Corporate Governance Code and professional standards in Germany and the United States. In particular

- 1) We verified that no professional relationships to the Company exist that may reasonably be thought to bear on our independence. This relates especially to board membership and employee relationships with the Company.
- 2) We verified that no financial relationships exist that may reasonably be thought to bear on our independence. This relates especially to direct investments such as stocks, bonds and similar investments. We are also independent in respect to the requirements of § 319 paragraph 2 no. 8 HGB. For each of the last five years our annual revenues generated from services to the Company and other entities for which the Company holds more than 20% ownership amounted to less than 30% in fact, less than 1% of our total revenues. This is also expected to be the case for the current fiscal year.
- 3) We will also ensure that anything which may reasonably be thought to bear on our independence with regard to the self review threat will be avoided. In particular, apart from the audit we have not taken part in the maintenance of any books or records or the preparation of financial statements and will not do so in future.

- 4) We will comply with the requirements regarding internal rotation (§ 319 paragraph 3 no. 6 HGB).
- 5) We are not aware of any other relationships or matters which may reasonably be thought to bear on our independence such as close family or personal relationships with the board members or management of the Company.

Our internal organization complies with the requirements of the "Gemeinsamen Stellungnahme der Wirtschaftsprüferkammer und des Instituts der Wirtschaftsprüfer in Deutschland: Zur Qualitätssicherung in der Wirtschaftsprüferpraxis" (VO 1/1995). Our partners are prohibited to have any financial investment in a KPMG audit client. All other professional staff is prohibited to have any financial investment in an audit client he or she delivers services to. The affected persons have to declare that they comply with these regulations on a regular basis."

**Declaration of conformity with regard to the German corporate governance code**

"Dialog Semiconductor Plc has established and published its own corporate governance principles corresponding in substance to the provisions of the German "Declaration on Corporate Governance" as published on November 13, 2002 thereby adopting in substance the recommendations of the Government Commission on the German Corporate Governance Code".

This declaration is available on the Internet at: [www.dialog-semiconductor.com/InvestorRelations/Corporate Governance](http://www.dialog-semiconductor.com/InvestorRelations/CorporateGovernance).

London, February 2004

Jan Tufvesson, Chairman

## Members of the Board of Directors

### **Jan Olof Ingemar Tufvesson, Chairman (65)**

joined the board of our then-holding company in 1990 and has served as chairman of the board since March 1998. Between 1972 and 1980 he held senior appointments on the Royal Swedish Air Force Board. In 1980 he joined Ericsson where he had a number of executive roles, the last being a vice president at LM Ericsson corporate, responsible for all procurement in Ericsson and for developing relations with key suppliers. Mr. Tufvesson graduated from the Royal University of Technology in Stockholm with a masters degree in electronic engineering in 1962. Mr. Tufvesson retired from Ericsson in 1998 and is now active as an independent management consultant, based in Stockholm.

### **Roland Pudelko, Chief Executive Officer and President (51)**

joined us in 1989 as managing director and has served as Executive Director, CEO and President since March 1998. He has over 20 years experience in electronics and microelectronics, primarily in management positions within the Daimler-Benz Group. During that time, he was on the board of a joint venture with ACER of Taiwan, and in the TEMIC Group he was responsible for worldwide design and engineering. Mr. Pudelko has a diploma in communication technologies. He is also the managing director of Dialog Semiconductor GmbH and other consolidated subsidiaries of Dialog Semiconductor Plc.

### **Timothy Richard Black Anderson (42)**

joined the board of our then-holding company in 1990 and has served as a director since February 1998. Mr. Anderson has been a partner with the London law firm Reynolds Porter Chamberlain since 1989, where he specializes in business law for media and technology companies. He holds a law degree from Southampton University and is qualified as a solicitor in England and Wales.

### **Michael John Glover (65)**

joined the board of our then-holding company in 1990 and has served as a director since March 1998. Mr. Glover was a senior executive with technology based companies in the United Kingdom, Europe, the Far East and North America prior to becoming involved in private equity fund management in 1985. He has a degree in economics from the University of Birmingham. Mr. Glover is currently Managing Director of Aylestone Strategic Management Limited and serves as a director of other companies including HgCapital Trust plc.

### **John McMonigall (60)**

has served as one of our directors since March 1998. He joined Apax Partners as a director in 1990 and is currently the director responsible for investments in telecommunications, software and related fields. Between 1986 and 1990, Mr. McMonigall held a variety of senior positions at British Telecom, including managing director of the customer service division. He was also a member of the management board of British Telecom. He is currently on the board of five other public and private companies, including Crane Telecommunications Ltd, Autonomy plc and Amphion Ltd.

**Gregorio Reyes (62)**

joined us as a director in December 2003, and has been a private investor and management consultant since 1994 with current board positions at companies including LSI Logic Corp., Appshop, Amphion Semiconductor, Astute Networks, Future Trade Technologies, and Nuera Communications. He has held various executive positions with National Semiconductor (1962-1967), Motorola (1967-1968) and Fairchild Semiconductor (1968-1978). He was also president and CEO of National Micronetics (1981-1984), and chairman and CEO of American Semiconductor Equipment Technologies (1986-1990), and of Sunward Technologies (1990-1994).

**Michael Risman (35)**

joined us as a director in August 1999, having been closely involved with our company since March 1998. He is a director of Apax Partners where he has responsibility for their European IT investments efforts and is a member of the International Approval Committee. Before joining Apax Partners in 1995, Mr. Risman worked for Cap Gemini as a consultant and for Jaguar Cars as an R&D engineer. He earned an MBA from Harvard Business School and an MA (Hons) degree in Electrical Engineering and Management from Cambridge University. He is also a director of Frontier Silicon (Holdings) Ltd, Red-M (Communications) Limited and Streamserve Inc.

## Investor Information

### ■ Annual Meeting

The annual meeting of Dialog Semiconductor Plc will be held on May 12, 2004  
9 a.m. local time  
278/282 High Holborn  
London WC1V 7HA  
United Kingdom

### ■ Corporate Calendar

April 28, 2004  
Release of first quarter results

May 12, 2004  
Annual shareholders' meeting

July 21, 2004  
Release of second quarter results

October 20, 2004  
Release of third quarter results

### ■ Corporate Counsel

Reynolds Porter Chamberlain  
London, United Kingdom

### ■ Certified Public Accountants

KPMG Deutsche Treuhand-Gesellschaft  
Stuttgart, Germany

### ■ US Listing

Our Shares are listed on Nasdaq in the form of American Depositary Shares (ADS). Each ADS represents one ordinary share.

### ■ ADS Administrator

ADS holders may instruct The Bank of New York, which administers our ADS program, as to the exercise of voting rights pertaining thereto:

Dialog Semiconductor is subject to the regulations of the Securities and Exchange Commission (SEC) in the USA as they apply to foreign companies and files with the SEC its Annual Report on Form 20-F and other information as required.

The Bank of New York  
101 Barclay Street, 22W  
New York, NY 10286  
Telephone: +1-888-269-2377  
Facsimile: +1-212-571-3050

### ■ Please direct inquiries to:

Dialog Semiconductor  
Birgit Hummel  
Neue Strasse 95  
D-73230 Kirchheim/Teck - Nabern  
Telephone: +49-7021-805-412  
Fax: +49-7021-805-200  
E-mail: birgit.hummel@diasemi.com

### ■ [www.dialog-semiconductor.com](http://www.dialog-semiconductor.com)

All our recent press releases are accessible together with the latest Annual and Interim Reports.

Publications of interest to current and potential investors (Form 20-F, Annual and Interim Reports) are available without charge upon request.

Please order within the investor relations section of our homepage.

# Technical Glossary

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

**APS** ■ Advanced Pixel Sensor technology used in Dialog Semiconductor's CMOS image sensors.

**ASIC** ■ Application Specific Integrated Circuit; an integrated chip custom designed for a specific application.

**ASSP** ■ Application Specific Standard Product; a semiconductor device integrated circuit (IC) dedicated to a specific application and sold to more than one user.

**Audio-CODEC** ■ The interface between analog signals (such as the human voice) and the digital data processing inside a mobile phone, determining voice quality.

**CAD** ■ Computer Aided Design, usually refers to a software tool used for designing electronics hardware or software systems.

**CDMA** ■ Code Division Multiple Access, an alternative to GSM technology for mobile wireless networks.

**Chips** ■ Electronic integrated circuits.

**CMOS** ■ Complimentary Metal Oxide Semiconductor, the most popular class of semiconductor manufacturing technology.

**DC-DC** ■ A DC-to-DC converter is a device that accepts a direct current input voltage and produces a direct current output voltage. The output is typically at a different voltage level than the input, and often the component provides power bus regulation.

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

**Foundry** ■ A manufacturing plant where wafers are produced.

**GPS** ■ Global Positioning System. A worldwide satellite navigation system used in many electronics systems for positional information.

**GPRS** ■ General Packet Radio Service, a step between GSM and 3G (third generation) mobile networks, offering fast data transmission via the GSM network.

**GSM** ■ Global System for Mobile Communications, the world's most widely used mobile system.

**IC** ■ Integrated Circuit; an electronic device with numerous components on a single chip.

**Imaging** ■ The capture and processing of images via an image sensor for use by an electronic device to send to a display for viewing by a user.

**Liquid Crystal Display (LCD)** ■ A display technology, commonly found in many portable electronics products, including personal organizers, cellular handsets and notebook computers.

**LDO** ■ Low Dropout voltage regulators are used in battery operated systems, where the output voltage is typically lower than the input voltage.

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

**MLA** ■ Multi-Line Addressing is a technology used in color LCDs to enable full colour, high quality display of moving images with fast response time, high brightness, lower cost and low power consumption.

**MP3** ■ (MPEG-1 Audio Layer-3) A standard technology format for compression of sound sequences into very small files, while preserving the original level of sound quality.

**Multimedia messaging services (MMS)** ■ A standardized messaging service for the mobile environment. MMS provides automatic, immediate delivery of user-created content from phone to phone, containing any combination of graphics, images and audio.

**NMT/TACS/AMPS** ■ Previous generation (analog) cellular network standards.

**Personal digital assistant (PDA)** ■ A hand-held computer designed for use as a personal organizer with communications capabilities.

**Power management** ■ The management of the power requirements of various subsystems, especially important in hand-held and portable electronics equipment.

**Semiconductor** ■ A base material halfway between a conductor and an insulator, which can be physically altered by mixing in certain atoms. Semiconductors form the basis for present-day electronics.

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

**Smart Mirror™** ■ A technology patented by Dialog Semiconductor which simplifies circuit design and provides very low current consumption in power management circuits.

**STN** ■ Super-Twisted Nematic, refers to the direction of rotation of the liquid crystals in an LCD to enable excellent brightness and a wide angle at which the display can be viewed before losing much contrast.

**System on chip (SOC)** ■ An advanced semiconductor device embedding custom circuits and third-party intellectual property (IP) elements into large single chip solutions.

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

# Financial Glossary

**Cash Flow** ■ The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an enterprise during a period. It helps to assess the enterprise's ability to generate positive future net cash flows. A statement of cash flows shall explain the change in cash and cash equivalents during the period by classifying cash receipts and payments according to whether they stem from operating, investing, or financing activities.

**Cash flow from operating activities** ■ Cash flow from operating activities includes all transactions and other events that are not defined as investing or financing activities in paragraphs. Operating activities generally involve producing and delivering goods and providing services. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income.

**Comprehensive Income** ■ The purpose of reporting comprehensive income is to report a measure of all changes in equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with owners such as capital increases or dividends. An example of items effecting comprehensive income is foreign currency translation adjustments resulting from the process of translating an entity's financial statements in a foreign currency into the reporting currency.

**Corporate Governance** ■ Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

**Deferred taxes** ■ Deferred tax assets or liabilities are temporary differences between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively.

**Derivative financial instruments** ■ A financial instrument that derives its value from the price or expected price of an underlying asset (e.g. a security, currency or bond).

**Goodwill** ■ Goodwill is to be recorded in a purchase business combination for an excess of the cost of the acquired enterprise over the total amount assigned to the identifiable assets acquired less liabilities assumed.

**Gross Margin** ■ Gross Margin equals the difference between revenues and cost of sales as presented in the statement of operations.

**Hedging** ■ A strategy used to minimize exposure to changes in prices, interest rates or exchange rates by means of derivative financial instruments (options, swaps, forward contracts, etc.).

**Impairment** ■ Impairment is the condition that exists when the carrying amount of a long-lived asset exceeds its fair value (the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset).

**Prime Standard** ■ The new segmentation of the equity market of the German Stock Exchange comprises a Prime Standard segment in addition to the General Standard segment that applies the statutory minimum requirements. The Prime Standard segment addresses companies that wish to target international investors. These companies are required to meet high international transparency criteria, over and above those set out by the General Standard.

**Restructuring Charges** ■ Costs associated with an exit or disposal activity, e.g. termination benefits provided to employees that are involuntarily terminated.

**Securities** ■ Debt securities are instruments representing a creditor relationship with an enterprise and include government securities, corporate bonds, commercial paper, and all securitized debt instruments. Available-for-sale securities are debt securities not classified as held-to-maturity or trading securities.

**Shareholders' equity** ■ Shareholders' equity reflects the investment of shareholders in a company. Shareholders' equity is comprised of ordinary shares, additional paid-in capital, retained earnings and accumulated other comprehensive income.

**Stock option plans** ■ Stock option plans include all agreements by an entity to issue shares of stock or other equity instruments to employees. Stock option plans provide employees the opportunity to receive stock resulting in an additional compensation based on the future share price performance. The purpose of stock option plans is to motivate employees to increase shareholder value on a long-term basis.

**Total Assets** ■ Total assets include all current and non-current assets. Total assets equal total liabilities and shareholders' equity.

**Working Capital** ■ Working capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business.



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