MICROCHIP TECHNOLOGY INC
Form 10-Q
February 06, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2006.

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________to __________

Commission File Number: 0-21184

MICROCHIP TECHNOLOGY INCORPORATED
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**86-0629024**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

2355 W. Chandler Blvd., Chandler, AZ 85224-6199
(480) 792-7200
(Address, Including Zip Code, and Telephone Number,
Including Area Code, of Registrant's
Principal Executive Offices)

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

Yes x No ¨

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). (Check One)

Yes ¨ No x

Shares Outstanding of Registrant’s Common Stock

Class	Outstanding at January 31, 2007
Common Stock, $0.001 par value	**216,092,607 shares**

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

ASSETS

	December 31, 2006 (Unaudited)	March 31, 2006 (Note 1)
Cash and cash equivalents	$ 153,277	$ 565,273
Short-term investments	575,275	199,491
Accounts receivable, net	120,085	139,361
Inventories	121,850	115,024
Prepaid expenses	15,929	11,369
Deferred tax assets	68,991	78,544
Other current assets	11,137	9,767
Total current assets	1,066,544	1,118,829
Property, plant and equipment, net	624,996	659,972
Long-term investments	536,008	520,360
Goodwill	31,886	31,886
Intangible assets, net	8,767	9,489
Other assets	10,259	10,060
Total assets	$ 2,278,460	$ 2,350,596

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term debt	$ 29,500	$ 268,954
Accounts payable	34,742	50,847
Accrued liabilities	218,494	189,687
Deferred income on shipments to distributors	92,135	99,481
Total current liabilities	374,871	608,969
Pension accrual	892	801
Deferred tax liability	13,205	14,637
Stockholders' equity:		
Preferred stock, $.001 par value; authorized 5,000,000 shares; no shares issued or outstanding.	---	---
Common stock, $.001 par value; authorized 450,000,000 shares; issued and outstanding 216,038,252 shares at December 31, 2006; issued and outstanding 213,614,343 shares at March 31, 2006.	216	214
Additional paid-in capital	713,611	639,238
Retained earnings	1,185,152	1,106,355
Deferred share-based compensation	---	(5,705)

Accumulated other comprehensive loss		(9,487)		(13,913)
Net stockholders' equity		1,889,492		1,726,189
Total liabilities and stockholders' equity	$	2,278,460	$	2,350,596

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)
(Unaudited)

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2006		2005		2006		2005	
Net sales	$	251,004	$	234,896	$	781,495	$	680,721
Cost of sales (1)		101,294		94,626		311,340		278,390
Gross profit		149,710		140,270		470,155		402,331
Operating expenses:								
Research and development (1)		28,043		23,377		85,151		70,409
Selling, general and administrative (1)		40,185		32,305		122,482		95,010
		68,228		55,682		207,633		165,419
Operating income		81,482		84,588		262,522		236,912
Other income (expense):								
Interest income		15,002		8,668		43,910		22,766
Interest expense		(890)		(559)		(5,146)		(1,497)
Other, net		260		374		452		1,572
Income before income taxes		95,854		93,071		301,738		259,753
Income tax provision		23,005		52,947		72,417		92,952
Net income	$	72,849	$	40,124	$	229,321	$	166,801
Basic net income per common share	$	0.34	$	0.19	$	1.07	$	0.80
Diluted net income per common share	$	0.33	$	0.19	$	1.04	$	0.78
Dividends declared per common share	$	0.250	$	0.160	$	0.700	$	0.380
Weighted average common shares outstanding		215,710		210,836		214,603		209,556
Weighted average common and potential common shares outstanding		220,920		215,667		219,837		214,293

(1) Includes share-based compensation charges as follow:								
Cost of sales	$	1,595	$	---	$	1,595	$	---
Research and development		2,432		73		7,245		94
Selling, general and administrative		3,714		118		10,874		182

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

	Nine months ended December 31, 2006	2005
Cash flows from operating activities:		
Net income	$ 229,321	$ 166,801
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	87,792	83,106
Deferred income taxes	7,563	37,139
Share-based compensation	19,714	276
Excess tax benefit from share-based payment arrangements	(14,648)	---
Tax benefit from equity incentive plans	14,659	17,651
Gain on sale of assets	(364)	(476)
Changes in operating assets and liabilities:		
Decrease in accounts receivable	19,276	1,113
Increase in inventories	(3,422)	(10,911)
Decrease in deferred income on shipments to distributors	(7,346)	(7,057)
Increase in accounts payable and accrued liabilities	12,702	39,147
Change in other assets and liabilities	(7,422)	(3,730)
Net cash provided by operating activities	357,825	323,059
Cash flows from investing activities:		
Purchases of investments	(1,087,068)	(531,852)
Sales and maturities of investments	700,620	360,648
Investment in other assets	(673)	(1,704)
Proceeds from sale of assets	1,746	819
Capital expenditures	(51,416)	(42,817)
Net cash used in investing activities	(436,791)	(214,906)
Cash flows from financing activities:		
Payment of cash dividend	(150,526)	(79,612)
Repurchase of common stock	---	(3,320)
Proceeds from sale of common stock	42,302	63,501
Excess tax benefit from share-based payment arrangements	14,648	---
Payments on short-term borrowings	(239,454)	---
Net cash used in financing activities	(333,030)	(19,431)
Net (decrease) increase in cash and cash equivalents	(411,996)	88,722

Cash and cash equivalents at beginning of period		565,273		68,730
Cash and cash equivalents at end of period	$	153,277	$	157,452

See accompanying notes to condensed consolidated financial statements

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Microchip Technology Incorporated and its wholly-owned subsidiaries (the "Company"). All intercompany balances and transactions have been eliminated in consolidation. We own 100% of the outstanding stock in all of our subsidiaries.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). In the opinion of management, all adjustments of a normal recurring nature which are necessary for a fair presentation have been included. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such SEC rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2006. The results of operations for the three and nine months ended December 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2007 or for any other period.

(2) Recently Issued Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48 is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective for the Company as of the beginning fiscal 2008. The Company is currently evaluating the impact, if any, that FIN 48 will have on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, that SFAS 157 will have on its financial statements.

In September 2006, the FASB issued SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ("SFAS 158") and is effective for the Company's fiscal year ended March 31, 2007. This standard requires companies to recognize, on a prospective basis, the funded status of their defined benefit pension and other postretirement benefit plans as a net liability or asset on their balance sheets. The Company is currently evaluating the impact, if any, that SFAS 158 will have on its financial statements.

(3) Share-Based Compensation

The Company has equity incentive plans under which non-qualified stock options and restricted stock units (RSUs) have been granted to employees and under which non-qualified stock options have been granted to non-employee members of the Board of Directors. In the second half of fiscal 2006, the Company adopted RSUs as its primary equity incentive compensation instrument for employees. The Company also has an employee stock purchase plan for all eligible employees. Effective April 1, 2006, the Company adopted FASB Statement of Financial Accounting Standards ("SFAS") No. 123R (revised 2004), *Share-Based Payment* ("SFAS 123R"). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, RSUs

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and employee stock purchase rights, to be recognized in the financial statements based on their respective grant date fair values and does not allow the previously permitted pro forma disclosure-only method as an alternative to financial statement recognition. SFAS 123R supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25") and related interpretations, and amends SFAS No. 95, *Statement of Cash Flows.* SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under previous literature. This requirement may reduce the Company's future net operating cash flows and increase net financing cash flows. In March 2005, the SEC issued SAB No. 107, *Share-Based Payment* ("SAB 107"), which provides guidance regarding the interaction of SFAS 123R and certain SEC rules and regulations. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified-prospective method of recognition of compensation expense related to share-based payments. The Company's unaudited condensed consolidated statement of income for the three and nine months ended December 31, 2006 reflects the impact of adopting SFAS 123R. In accordance with the modified-prospective transition method, the Company's unaudited condensed consolidated statements of income for prior periods have *not* been restated to reflect, and do not include, the impact of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense ratably over the requisite service periods. The Company has estimated the fair value of each award as of the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and that are freely transferable. The Black-Scholes model considers, among other factors, the expected life of the award and the expected volatility of the Company's stock price. Although the Black-Scholes model meets the requirements of SFAS 123R and SAB 107, the fair values generated by the model may not be indicative of the actual fair values of the Company's awards as it does not consider other factors important to those share-based payment awards such as, continued employment, periodic vesting requirements, and limited transferability.

Prior to the adoption of SFAS 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the condensed consolidated statements of cash flows. SFAS 123R requires the cash flows resulting from the tax benefits arising from tax deductions in excess of the compensation cost recognized for the equity incentives (excess tax benefits) to be classified as financing cash flows. The $14.6 million excess tax benefit classified as a financing cash inflow in the Company's accompanying condensed consolidated statements of cash flows for the nine months ending December 31, 2006 would have been classified as an operating cash inflow if the Company had not adopted SFAS 123R.

Prior to the adoption of SFAS 123R, the Company accounted for share-based payment awards to employees in accordance with APB 25 and related interpretations, and had adopted the disclosure-only alternative of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), and SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure.* In accordance with APB 25, share-based compensation expense was not recorded in connection with share-based payment awards granted with exercise prices equal to or greater than the fair market value of the Company's common stock on the date of grant, unless certain modifications were subsequently made. The Company recorded deferred compensation in connection with RSUs equal to the fair market value of the common stock on the date of grant. Recorded deferred compensation was recognized as share-based compensation expense ratably over the applicable vesting periods. In accordance with the provisions of SFAS 123R, all deferred compensation previously recorded has been eliminated with a corresponding reduction in additional paid in capital.

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. The Company uses the Black-Scholes option pricing model to estimate the fair value of employee stock options and rights to purchase shares under stock participation plans, consistent with the

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provisions of SFAS 123R. Option pricing models, including the Black-Scholes model, also require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. The Company uses a blend of historical and implied volatility based on options freely traded in the open market as it believes this is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The expected life of the awards is based on historical and other economic data trended into the future. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of the Company’s awards. The dividend yield assumption is based on the Company’s history and expectation of future dividend payouts. The fair value of our RSUs is based on the fair market value of the Company’s common stock on the date of grant discounted for expected future dividends. SFAS 123R requires the Company to develop an estimate of the number of share-based awards which will be forfeited due to employee turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. If forfeiture adjustments are made, they would affect the Company’s gross margin, research and development expenses, and selling, general, and administrative expenses. The effect of forfeiture adjustments in the third quarter of fiscal 2007 was immaterial.

The Company evaluates the assumptions used to value its awards on a quarterly basis. If factors change and the Company employs different assumptions, share-based compensation expense may differ significantly from what was recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, the Company may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that the Company grants additional equity awards to employees or it assumes unvested equity awards in connection with acquisitions. Had the Company adopted SFAS 123R in prior periods, the magnitude of the impact of that standard on its results of operations would have approximated the impact of SFAS 123 assuming the application of the Black-Scholes option pricing model as described in the disclosure of pro forma net income and pro forma net income per share in Note 10 to the Company’s Unaudited Condensed Consolidated Financial Statements.

(4) <u>Investments</u>

The Company’s investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company’s investment guidelines and market conditions. The following is a summary of available-for-sale securities at December 31, 2006 (amounts in thousands):

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
State student loan bonds	$ 43,425	$ ---	$ ---	$ 43,425
Government agency bonds	740,564	---	10,528	730,036
Commercial paper	10,000	---	25	9,975
Floating rate securities	329,035	---	1,188	327,847
	$ 1,123,024	$ ---	$ 11,741	$ 1,111,283

During the three and nine months ended December 31, 2006, the Company did not have any gross realized gains or losses on sales of available-for-sale securities. During the three and nine months ended December 31, 2005, the Company had gross realized losses on available-for-sale securities of eight thousand dollars.

At December 31, 2006, the Company evaluated its investment portfolio, and noted unrealized losses of $11.7 million due to fluctuations in interest rates. Management does not believe any of the unrealized losses represented an other-than-temporary impairment based on its evaluation of available evidence as of December 31, 2006. The Company's intent is to hold these investments until such time as these assets are no longer impaired. For those investments not scheduled to mature until after December 31, 2007, such recovery is not anticipated to occur in the next year and these investments have been classified as long-term investments. At December 31, 2006, short-term investments consisted of $575.3 million and long-term investments consisted of $536.0 million.

The amortized cost and estimated fair value of the available-for-sale securities at December 31, 2006, by maturity, are shown below (amounts in thousands). Expected maturities can differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations.

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale				
Due in one year or less	$ 576,741	$ ---	$ 1,466	$ 575,275
Due after one year and through five years	546,283	---	10,275	536,008
	$ 1,123,024	$ ---	$ 11,741	$ 1,111,283

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006 (amounts in thousands):

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
State student loan bonds	$ 43,425	$ ---	$ ---	$ ---
Government agency	218,464	817	511,572	9,711
Commercial paper	9,975	25	---	---
Floating rate securities	303,411	624	24,436	564
	$ 575,275	$ 1,466	$ 536,008	$ 10,275

The unrealized losses on the Company's investments were caused by interest rate increases. The contractual cash flows of those investments are either guaranteed by a government agency or are investments in corporations with credit ratings of AA or higher. Accordingly, it is expected that the securities will not settle at prices less than the amortized cost of the Company's investment.

Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, it does not consider the investments with unrealized losses to be other than temporarily impaired at December 31, 2006.

(5) Accounts Receivable

Accounts receivable consists of the following (amounts in thousands):

	December 31, 2006	March 31, 2006
Trade accounts receivable	$ 123,126	$ 142,703
Other	502	320
	123,628	143,023
Less allowance for doubtful accounts	3,543	3,662
	$ 120,085	$ 139,361

(6) Inventories

The components of inventories consist of the following (amounts in thousands):

	December 31, 2006	March 31, 2006
Raw materials	$ 4,974	$ 3,505
Work in process	82,267	80,947
Finished goods	34,609	30,572
	$ 121,850	$ 115,024

Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable.

(7) Property, Plant and Equipment

Property, plant and equipment consists of the following (amounts in thousands):

	December 31, 2006	March 31, 2006
Land	$ 47,212	$ 47,212
Building and building improvements	371,717	366,055
Machinery and equipment	1,050,242	991,452
Projects in process	72,308	87,341
	1,541,479	1,492,060
Less accumulated depreciation and amortization	916,483	832,088
	$ 624,996	$ 659,972

Depreciation expense attributed to property and equipment was $86.4 million in the nine months ended December 31, 2006 and $82.2 million in the nine months ended December 31, 2005.

(8) Short-term Debt

The Company had short-term debt of $29.5 million and $269.0 million at December 31, 2006 and March 31, 2006, respectively. The short-term debt is a result of repurchase agreements that are in place with an investment brokerage. The short-term debt was collateralized with $47.3 million and $277.6 million of available-for-sale investments at December 31, 2006 and March 31, 2006, respectively. The short-term debt had a weighted average interest rate of 5.32% and 4.83% as of December 31, 2006 and March 31, 2006, respectively. In fiscal 2006, the borrowings were made to complete a $500 million repatriation of foreign earnings under the American Jobs Creation Act. The borrowings were collateralized against investments that are held by the Company's offshore subsidiaries. The Company presently intends to pay down the short-term borrowings as the investments mature and also from future offshore cash generation. In the nine months ended December 31, 2006, $239.5 million of short-term borrowings were paid down. There are no covenants associated with the repurchase agreements.

(9) **Comprehensive Income**

Comprehensive income consists of net income and net unrealized gains (losses) on available-for-sale investments. The components of other comprehensive income (loss) and related tax effects were as follows (amounts in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
(Decrease) increase in unrealized losses on investments, net of tax effect of $112, $400, ($558) and $280, respectively	$ (487)	$ 2,107	$ (4,426)	$ 1,900

(10) **Employee Benefit Plans**

Equity Incentive Plans

The Company has equity incentive plans under which incentive stock options have been granted to employees and RSUs and non-qualified stock options have been granted to employees and under which non-qualified stock options have been granted to non-employee members of the Board of Directors. The Company's 2004 Equity Incentive Plan, as amended and restated (the "2004 Plan"), is shareholder approved and permits the grant of stock options and RSUs to employees, non-employee members of the Board of Directors and consultants. At December 31, 2006, 12.0 million shares remained available for future grant under the 2004 Plan. Stock options and RSUs are designed to reward employees for their long-term contributions to the Company and to provide incentive for them to remain employed with the Company. The Company believes that such awards better align the interests of its employees with those of its shareholders.

The Board of Directors or the plan administrator determines eligibility, vesting schedules and exercise prices for equity incentives granted under the plans. Equity incentives granted generally have a term of 10 years, and in the case of newly hired employees generally vest and become exercisable at the rate of 25% after one year of service and ratably on a monthly or quarterly basis over a period of 36 months thereafter; subsequent equity incentive grants to existing employees generally vest and become exercisable ratably on a monthly or quarterly basis over a period starting in 48 months and ending in 60 months after the date of grant.

Share-Based Compensation Expense

The following table presents details of share-based compensation expense resulting from the application of SFAS 123R (amounts in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006[1]	2005	2006[1]	2005
Cost of sales	$ 1,595[2]	$ ---	$ 1,595[2]	$ ---
Research and development	2,431	73	7,244	94
Selling, general and administrative	3,714	118	10,874	182
Share-based compensation effects in income before taxes	7,740	191	19,713	276
Income taxes	1,857	46	4,730	66
Net share-based compensation effects in net income	$ 5,883	$ 145	$ 14,983	$ 210
Share-based compensation effects on base earnings per common share	$ 0.02	$ ---	$ 0.07	$ ---
Share-based compensation effects on diluted earnings per common share	$ 0.03	$ ---	$ 0.07	$ ---

(1) The amounts included in the three and nine months ended December 31, 2006 reflect the adoption of SFAS 123R. In accordance with the modified prospective transition method, the Company's unaudited condensed consolidated statements of income for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R.

(2) During the three months ended December 31, 2006, $1.7 million was capitalized to inventory, of which none was sold. During the nine months ended December 31, 2006, $5.0 million was capitalized to inventory of which $1.6 million was sold.

The amount of unearned share-based compensation currently estimated to be expensed in the remainder of fiscal 2007 through fiscal 2012 related to unvested share-based payment awards at December 31, 2006 is $71.0 million. The weighted average period over which the unearned share-based compensation is expected to be recognized is approximately 2.25 years.

In accordance with the requirements of the disclosure-only alternative of SFAS 123, set forth below is a pro forma illustration of the effect on net income and net income per share computed as if the Company had valued share-based awards to employees using the Black-Scholes option pricing model instead of applying the guidelines provided by APB 25 in the three and nine months ended December 31, 2005 (in thousands, except per share amounts):

	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2005
Net income, as reported	$ 40,124	$ 166,801
Deduct: Total share-based employee compensation expense determined under fair value methods for all awards, net of related tax effects.	3,432	12,769
Pro forma net income	$ 36,692	$ 154,032
Net income per common share:		
Basic, as reported	$ 0.19	$ 0.80
Basic, pro forma	$ 0.17	$ 0.74
Diluted, as reported	$ 0.19	$ 0.78
Diluted, pro forma	$ 0.17	$ 0.72

Combined Incentive Plan Information

RSU activity under the 2004 Plan in the nine months ended December 31, 2006 is set forth below:

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	Number of Shares
Balance at March 31, 2006	195,524
Restricted stock units granted under the 2004 Plan	1,598,038
Restricted stock units cancelled	(79,279)
Restricted stock units vested	(12,438)
Balance at December 31, 2006	1,701,845

The total pre-tax intrinsic value of RSUs which vested during the three and nine months ended December 31, 2006 was immaterial. The aggregate pre-tax intrinsic value of RSUs outstanding at December 31, 2006 was $55.4 million. The aggregate pre-tax intrinsic value was calculated based on the closing price of the Company's common stock of $32.70 on December 29, 2006. At December 31, 2006, the weighted average remaining expense recognition period was 2.67 years.

The weighted average fair values per share of the RSUs awarded in the three and nine months ended December 31, 2006 were $27.16 and $31.41, respectively, calculated based on the fair market value of the Company's common stock on the respective grant dates discounted for the Company's expected dividend yield. The weighted average fair values per share of RSUs awarded in the three and nine months ended December 31, 2005 were $30.85 and $27.91, respectively, calculated based on the intrinsic value of the instrument on the date of grant.

Option activity under the Company's stock incentive plans in the nine months ended December 31, 2006 is set forth below:

	Number of Shares	Weighted Average Exercise Price per Share
Balance at March 31, 2006	18,450,360	$ 20.97
Options granted under the 2004 Plan	58,208	34.63
Options cancelled	(318,989)	24.28
Options exercised	(2,208,295)	16.39
Balance at December 31, 2006	15,981,284	$ 21.58

The total pre-tax intrinsic value of options exercised during the three and nine months ended December 31, 2006 was $9.0 million and $40.3 million, respectively. This intrinsic value represents the difference between the fair market value of the Company's common stock on the date of exercise and the exercise price of each equity award.

The following table summarizes information about the stock options outstanding at December 31, 2006:

Range of Exercise Prices	Number of Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life	Number Exercisable	Weighted Average Exercise Price

			(in years)		
$1.82-$10.04	2,139,940	$ 8.47	1.84	2,139,155	$ 8.47
10.05 - 15.92	1,633,160	15.62	4.08	1,633,160	15.62
15.93 - 18.48	1,968,993	18.40	6.10	660,208	18.25
18.49 - 23.39	1,940,139	22.35	3.82	1,929,349	22.36
23.40 - 25.26	1,017,826	24.21	5.36	1,010,642	24.20
25.27 - 25.29	1,680,455	25.29	8.25	16,662	25.29
25.30 - 27.05	2,284,560	26.76	7.15	733,157	26.25
27.06 - 27.15	1,991,797	27.15	5.25	1,991,797	27.15
27.16 - 36.10	1,292,367	29.53	6.53	907,584	29.39
36.11 - 37.06	32,047	37.06	9.25	0	0.00
$1.82-$37.06	15,981,284	$ 21.58	5.31	11,021,714	$ 20.30

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The aggregate pre-tax intrinsic value of options outstanding and options exercisable at December 31, 2006 was $177.9 million and $136.8 million, respectively. The aggregate pre-tax intrinsic values were calculated based on the closing price of the Company's common stock of $32.70 on December 29, 2006.

The weighted average fair values per share of stock options granted in the nine months ended December 31, 2006 was $11.95. There were no stock options granted for the three months ended December 31, 2006.

The weighted average fair values per share of stock options granted in connection with the Company's stock incentive plans in the three months ended December 31, 2005 were estimated utilizing the following assumptions:

	Three Months Ended December 31, 2005
Expected life (in years)	5.20
Volatility	43%
Risk-free interest rate	4.40%
Dividend yield	2.36%

Employee Stock Purchase Plan

The Company has an employee stock purchase plan and an international employee stock purchase plan (the "Purchase Plans") for all eligible employees. Under the Purchase Plans, employees may purchase shares of the Company's common stock at six-month intervals at 85% of fair market value (calculated in the manner provided in the plan). Employees purchase such stock using payroll deductions, which may not exceed 10% of their total cash compensation. The Purchase Plans impose certain limitations upon an employee's right to acquire common stock, including the following: (i) no employee may purchase more than 7,500 shares of common stock on any purchase date and (ii) no employee may be granted rights to purchase more than $25,000 of common stock for each calendar year in which such rights are at any time outstanding. At December 31, 2006, 3.6 million shares were available for future issuance under the Purchase Plans. The Company issued 204,888 shares under the Purchase Plans in the nine months ended December 31, 2006.

The weighted average fair values per share of stock purchased in connection with the Company's stock purchase plan have been estimated using the following assumptions:

	Three Months Ended December 31,	
	2006	2005
Expected life (in years)	0.50	0.50
Volatility	29%	43%
Risk-free interest rate	5.15%	4.40%
Dividend yield	3.50%	2.36%

(11) Net Income Per Share

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

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	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Net income	$ 72,849	$ 40,124	$ 229,321	$ 166,801
Weighted average common shares outstanding	215,710	210,836	214,603	209,556
Dilutive effect of stock options	5,210	4,831	5,234	4,737
Weighted average common and potential common shares outstanding	220,920	215,667	219,837	214,293
Basic net income per common share	$ 0.34	$ 0.19	$ 1.07	$ 0.80
Diluted net income per common share	$ 0.33	$ 0.19	$ 1.04	$ 0.78

(12) **Stock Repurchase**

On April 22, 2004, the Company announced that its Board of Directors had authorized the Company to purchase up to 2.5 million shares of its common stock in the open market or in privately negotiated transactions. As of December 31, 2006, the Company had repurchased 1,004,834 shares under this authorization. As of December 31, 2006, all of the purchased shares were used to fund stock option exercises and purchases under the Company's employee stock purchase plans. On October 25, 2006, the Company announced that its Board of Directors had authorized the repurchase of up to an additional 10 million shares of its common stock in the open market or in privately negotiated transactions. The timing and amount of future repurchases will depend upon market conditions, interest rates and corporate considerations.

(13) **Dividends**

On October 28, 2002, the Company announced that its Board of Directors had approved and instituted a quarterly cash dividend on its common stock. A quarterly cash dividend of $0.25 per share was paid on November 22, 2006 in the aggregate amount of $54.0 million. A quarterly cash dividend of $0.265 per share was declared on January 31, 2007 and will be paid on February 28, 2007 to shareholders of record as of February 14, 2007. The Company expects the February 2007 payment of its quarterly cash dividend to be approximately $57.4 million.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This report, including "Part I - Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II - Item 1A Risk Factors" contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "future," "intend" and similar expressions to identify forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under "Risk Factors," beginning at page 31 and elsewhere in this Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement. These forward-looking statements include, without limitation, statements regarding the following:

- The effects and amount of competitive pricing pressure on our product lines;
- Our ability to moderate future average selling price declines;
- The effect of product mix on gross margin;
- The amount of changes in demand for our products and those of our customers;
- The level of orders that will be received and shipped within a quarter;
- The effect that distributor and customer inventory holding patterns will have on us;
- Our belief that customers recognize our products and brand name and use distributors as an effective supply channel;

- Our belief that our direct sales personnel combined with out distributors provide an effective means of reaching our customer base;
- Our ability to increase the proprietary portion of our analog and interface product lines and the effect of such an increase;
- The impact of any supply disruption we may experience;
- Our ability to effectively utilize our facilities at appropriate capacity levels and anticipated costs;
- That our capital expenditures over the next 12 months will provide sufficient manufacturing capability to meet our anticipated needs;
- That manufacturing costs will be reduced by transition to advanced process technologies;
- Our ability to absorb fixed costs, labor and other direct manufacturing costs;
- Our ability to maintain manufacturing yields;
- Continuing our investments in new and enhanced products;
- The ability to attract and retain qualified personnel;
- The cost effectiveness of using our own assembly and test operations;
- Our anticipated level of capital expenditures;
- Continuing to receive patents on our inventions;
- Continuation of quarterly cash dividends;
- The sufficiency of our existing sources of liquidity;
- The impact of seasonality on our business;
- Expected impact of SFAS 123R on our business;
- Input assumptions made in our estimate of the fair value of employee stock options and employee stock purchase rights not limited to the dividend yield, life expectancy, volatility, forfeiture rate, and risk-free rate of return;
- That the resolution and costs of legal actions will not harm our business;
- That the idling of assets will not impair the value of such assets;
- Our expectation to pay-down short-term borrowings;
- The recoverability of our deferred tax assets;
- The adequacy of our tax reserves to offset any potential tax liabilities;
- Our belief that the expiration of any tax holidays will not have a material impact;
- The ability to obtain title to land underlying our Thailand facility, its fair value and adequacy of associated reserves;
- The accuracy of our estimates of the useful life and values of our property and equipment;
- Our ability to obtain intellectual property licenses;
- The level of risk we are exposed to for product liability claims;
- The amount of labor unrest, political instability, governmental interference and changes in general economic conditions that we experience;
- The effect of changes in market interest rates on income and/or cash flows;
- The effect of fluctuations in currency rates;
- Timing and amount of repurchases of common stock;
- Availability of financing on acceptable terms; and
- Costs of compliance with governmental regulations such as Section 404 of Sarbanes-Oxley.

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of Microchip's overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three and nine months ended December 31, 2006 compared to the three and nine months ended December 31, 2005. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial

commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

Strategy

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on embedded control products, which include microcontrollers, high-performance linear and mixed signal devices, power management and thermal management devices, and complementary microperipheral products including interface devices, Serial EEPROMs, and our patented KeeLoq security devices. We provide highly cost-effective embedded control products that also offer the advantages of small size, high performance, low voltage/power operation and ease of development, enabling timely and cost-effective embedded control product integration by our customers.

Our manufacturing operations include wafer fabrication and assembly and test. The ownership of our manufacturing resources is an important component of our business strategy, enabling us to maintain a high level of manufacturing control resulting in us being one of the lowest cost producers in the embedded control industry. By owning our wafer fabrication facilities and much of our assembly and test operations, and by employing statistical process control techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture the wafer manufacturing and a portion of the assembly and test profit margin.

We employ proprietary design and manufacturing processes in developing our embedded control products. We believe our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs. While many of our competitors develop and optimize separate processes for their logic and memory product lines, we use a common process technology for both microcontroller and non-volatile memory products. This allows us to more fully leverage our process research and development costs and to deliver new products to market more rapidly. Our engineers utilize advanced computer-aided design (CAD) tools and software to perform circuit design, simulation and layout, and our in-house photomask and wafer fabrication facilities enable us to rapidly verify design techniques by processing test wafers quickly and efficiently.

We are committed to continuing our investment in new and enhanced products, including development systems, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. Our current research and development activities focus on the design of new microcontrollers, digital signal controllers, ASSPs, memory and mixed-signal products, new development systems, software and application-specific software libraries. We are also developing new design and process technologies to achieve further cost reductions and performance improvements in existing products.

We market our products worldwide primarily through a network of direct sales personnel and distributors. Our distributors focus primarily on servicing the product and technical support requirements of a broad base of diverse customers. We believe that our direct sales personnel combined with our distributors provide an effective means of reaching this broad and diverse customer base. Our direct sales force focuses primarily on major strategic accounts in three geographical markets: the Americas, Europe and Asia. We currently maintain sales and support centers in major metropolitan areas in North America, Europe and Asia. We believe that a strong technical service presence is essential to the continued development of the embedded control market. Many of our field sales engineers (FSEs), field application engineers (FAEs), and sales management have technical degrees and have been previously employed in an engineering environment. We believe that the technical knowledge of our sales force is a key competitive advantage in the sale of our products. The primary mission of our FAE team is to provide technical assistance to strategic accounts and to conduct periodic training sessions for FSEs and distributor sales teams. FAEs also frequently conduct technical seminars in major cities around the world, and work closely with our distributors to provide technical assistance and end-user support.

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Critical Accounting Policies and Estimates

General

Our discussion and analysis of Microchip's financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We review the accounting policies we use in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, share-based compensation, inventories, income taxes, property plant and equipment, impairment of property, plant and equipment and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. We review these estimates and judgments on an ongoing basis. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. We also have other policies that we consider key accounting policies, such as our policy regarding revenue recognition to OEMs; however, we do not believe these policies require us to make estimates or judgments that are as difficult or subjective as our policies described below.

Revenue Recognition - Distributors

Our distributors worldwide have broad rights to return products and price protection rights, so we defer revenue recognition until the distributor sells the product to their customers. We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to distributors on the inventory that they have on hand at the date the price protection is offered. When we reduce the price of our products, it allows the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it has on hand as of the date of the price reduction. There is no revenue impact to us from the price protections. We also grant certain credits to our distributors. The credits are granted to the distributors on specially identified pieces of the distributors' business to allow them to earn a competitive gross margin on the sale of our products to their end customers. The credits are on a per unit basis and are not given to the distributor until they provide documentation of the sale to their end customer. The effect of granting these credits establishes the net selling price from us to our distributors for the product and results in the net revenue recognized by us when the product is sold by the distributors to their end customers. Upon our shipment to distributors, amounts billed are included as accounts receivable, inventory is relieved, and the sale and the gross margin are deferred and are reflected as a current liability until the product is sold by the distributor to their customers.

Share-based Compensation

In the first quarter of fiscal 2007, we adopted SFAS 123R, which requires the measurement at fair value and recognition of compensation expense for all share-based payment awards, including grants of employee stock options, RSUs and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. Total share-based compensation during the nine months ended December 31, 2006 was $23.0 million, of which $18.1 million was reflected in operating expenses, $1.6 million was reflected in cost of goods sold and $3.3 million was capitalized to inventory.

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. We use the Black-Scholes option pricing model to estimate the fair value of employee stock options and rights to purchase shares under stock participation plans, consistent with the provisions of SFAS 123R. Option pricing models, including the Black-Scholes model, also require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. We use a blend of historical and implied volatility based on options freely traded in the open market as we believe this is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The expected life of the awards is based on historical and other economic data trended into the future. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on our history and expectation of future dividend payouts. The fair value of our RSUs is based on the fair market value of our common stock on the date of grant discounted for expected future dividends. SFAS 123R requires us to develop an estimate of the number of share-based awards which will be forfeited due to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. If forfeiture adjustments are made, they would affect our gross margin, research and development expenses, and selling, general, administrative expenses. The effect of forfeiture adjustments in the first nine months of fiscal 2007 was immaterial.

We evaluate the assumptions used to value our awards on a quarterly basis. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions. Had we adopted SFAS 123R in prior periods, the magnitude of the impact of that standard on our results of operations would have approximated the impact of SFAS 123 assuming the application of the Black-Scholes option pricing model as described in the disclosure of pro forma net income and pro forma net income per share in Note 10 to our Unaudited Condensed Consolidated Financial Statements.

Inventories

Inventories are valued at the lower of cost or market using the first-in, first-out method. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. In estimating our inventory obsolescence, we primarily evaluate estimates of demand over a 12-month period and record impairment charges for inventory on hand in excess of the estimated 12-month demand.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income within the relevant jurisdiction and to the extent we believe that recovery is not likely, we must establish a valuation allowance. We have not provided for a valuation allowance because we believe that it is more likely than not that our deferred tax assets will be recovered from future taxable income. Should we

determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. At December 31, 2006, our gross deferred tax asset was $69.0 million.

Various taxing authorities in the United States and other countries in which we do business are increasing their scrutiny of various tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently under audit by the United States Internal Revenue Service ("IRS") for our fiscal years ended March 31, 1998, 1999, 2000 and 2001. As part of this ongoing audit, the IRS has proposed certain adjustments related to positions reflected on these returns. The IRS has issued formal assessments for these adjustments. We do not agree with these adjustments and are appealing these assessments. We recognize liabilities for anticipated tax audit issues in the United States and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon final resolution of the pending audit through either settlement or the appeals process with the IRS. The IRS is also currently auditing our fiscal years ended March 31, 2002, 2003 and 2004. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other audits in the United States and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

Property, Plant & Equipment

Property, plant and equipment are stated at cost. Major renewals and improvements are capitalized, while maintenance and repairs are expensed when incurred. At December 31, 2006, the carrying value of our property and equipment totaled $625.0 million, which represents 27.4% of our total assets. This carrying value reflects the application of our property and equipment accounting policies, which incorporate estimates, assumptions and judgments relative to the useful lives of our property and equipment. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets, which range from five to seven years on manufacturing equipment and approximately 30 years on buildings.

We began production activities at Fab 4 on October 31, 2003. We began to depreciate the Fab 4 assets as they were placed in service for production purposes. As of December 31, 2006, all of the buildings and supporting facilities were being depreciated as well as the manufacturing equipment that had been placed in service. All manufacturing equipment that was not being used in production activities was maintained in projects in process and is not being depreciated until it is placed into service since management believes there will be no change to its utility from the present time until it is placed into productive service. The lives to be used for depreciating this equipment at Fab 4 will be evaluated at such time as the assets are placed in service. We do not believe that the temporary idling of such assets has impaired the estimated life or carrying values of the underlying assets.

On March 31, 2005, we changed the classification of Fab 3 from an asset held-for-sale to an asset held-for-future-use. Fab 3 had been on the market for over two years, and we had not received any acceptable offers on the facility. Over that period of time, our business had increased significantly and over the next several years we will need to begin planning for future wafer fabrication capacity as a larger percentage of Fab 4's clean room capacity is utilized. We determined that the appropriate action to take was to stop actively marketing the Fab 3 facility and hold it for our future use. As a result of this change in classification, we had to assess the fair value of the Fab 3 asset to determine if any additional impairment charge was required upon the change in classification from "held-for-sale" to "held-for-future-use" under SFAS No. 144. We performed a discounted cash flow analysis of the Fab 3 asset based on various financial projections in developing the fair value estimate given that it was the best available valuation technique for the asset. The discounted cash flow analysis confirmed the carrying value of the Fab 3 asset at March 31, 2005 was not in excess of its fair value. If indicators of impairment for the

Fab 3 assets arise in the future, we will determine if the sum of the estimated undiscounted cash flows attributable to the assets in question are less than their carrying value. If less, we would recognize an impairment loss on the excess of the carrying amount of the assets over their respective fair values. We began to depreciate the Fab 3 asset in April 2005.

The estimates, assumptions and judgments we use in the application of our property and equipment policies reflect both historical experience and expectations regarding future industry conditions and operations. The use of different estimates, assumptions and judgments regarding the useful lives of our property and equipment and expectations regarding future industry conditions and operations, could result in materially different carrying values of assets and results of operations.

We do not currently hold title to the land on which our Thailand facility resides. The land is subject to a bankruptcy relating to the seller of the land. We have provided reserves that we estimate will be adequate to obtain full title. Such reserves are set at the estimated fair value of the land. However, timing of the resolution is difficult to predict and the ultimate amount to be paid could change.

Impairment of Property, Plant and Equipment

We assess whether indicators of impairment of long-lived assets are present. If such indicators are present, we determine whether the sum of the estimated undiscounted cash flows attributable to the assets in question is less than their carrying value. If less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by discounted future cash flows, appraisals or other methods. If the assets determined to be impaired are to be held and used, we recognize an impairment loss through a charge to our operating results to the extent the present value of anticipated net cash flows attributable to the asset are less than the asset's carrying value, which we depreciate over the remaining estimated useful life of the asset. We may incur impairment losses, or additional losses on already impaired assets, in future periods if factors influencing our estimates change.

Litigation

Our current estimated range of liability related to pending litigation is based on the probable loss of claims for which we can estimate the amount and range of loss. Recorded reserves were not significant at December 31, 2006.

Because of the uncertainties related to both the probability of loss and the amount and range of loss on our pending litigation, we are unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates. Revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

Results of Operations

The following table sets forth certain operational data as a percentage of net sales for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	40.4%	40.3%	39.8%	40.9%
Gross profit	59.6%	59.7%	60.2%	59.1%
Research and development	11.2%	10.0%	10.9%	10.3%

Selling, general and administrative	16.0%	13.7%	15.7%	14.0%
Operating income	32.5%	36.0%	33.6%	34.8%

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Net Sales

We operate in one industry segment and engage primarily in the design, development, manufacture and marketing of semiconductor products. We sell our products to distributors and original equipment manufacturers, referred to as OEMs, in a broad range of market segments, perform ongoing credit evaluations of our customers and generally require no collateral.

Our net sales for the quarter ended December 31, 2006 were $251.0 million, a decrease of 6.3% from the previous quarter's sales of $267.9 million, and an increase of 6.9% from net sales of $234.9 million in the quarter ended December 31, 2005. Our net sales for the nine months ended December 31, 2006 were $781.5 million, an increase of 14.8% from net sales of $680.7 million in the nine months ended December 31, 2005. The changes in net sales in these periods resulted primarily from changes in market conditions across all of our product lines. Average selling prices for our products were down approximately 2% for the three-month period ended December 31, 2006 and up approximately 1% for the nine-month period ended December 31, 2006 over the corresponding periods of the previous fiscal year. The number of units of our products sold were up approximately 8% and 14% for the three and nine-month periods ended December 31, 2006 over the corresponding periods of the previous fiscal year. The average selling prices and the unit volumes of our sales are impacted by the mix of our products sold. Key factors in achieving the amount of net sales during the three and nine-month periods ended December 31, 2006 include:

- continued market share gains;
- increasing semiconductor content in our customers' products;
- customers' increasing needs for the flexibility offered by our programmable solutions;
- our new product offerings that have increased our served available market;
- increasing demand for our products;
- economic conditions in the markets we serve; and
- inventory holding patterns of our customers.

We recognize revenue from product sales upon shipment to OEMs. Under our shipping terms, legal title passes to the customer upon shipment from Microchip. We have no post-shipment obligations. Distributors generally have broad rights to return products and price protection rights, so we defer revenue recognition until the distributors sell the product to their customers. Upon shipment, amounts billed to distributors are included in accounts receivable, inventory is relieved, the sale is deferred and the gross margin is reflected as a current liability until the product is sold by the distributors to their customers.

Sales by product line for the three and nine months ended December 31, 2006 and December 31, 2005 were as follows (dollars in thousands):

	Three Months Ended December 31, (unaudited)				Nine Months Ended December 31, (unaudited)			
	2006	%	2005	%	2006	%	2005	%
Microcontrollers	$ 200,073	79.7%	$ 186,235	79.3%	$ 626,167	80.1%	$ 540,817	79.4%
Memory products	30,105	12.0%	31,323	13.3%	92,843	11.9%	93,907	13.8%
Analog and interface products	20,826	8.3%	17,338	7.4%	62,485	8.0%	45,997	6.8%
Total sales	$ 251,004	100.0%	$ 234,896	100.0%	$ 781,495	100.0%	$ 680,721	100.0%

Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 79.7% of our total net sales for the three-month period ended December 31, 2006 and approximately 80.1% of our total net sales for the nine-month period ended December 31, 2006 compared to approximately 79.3% of our total net sales for the three-month period ended December 31, 2005 and approximately 79.4% of our total net sales for the nine-month period ended December 31, 2005.

Net sales of our microcontroller products increased approximately 7.4% in the three-month period ended December 31, 2006 and 15.8% in the nine-month period ended December 31, 2006 compared to the three and nine-month periods ended December 31, 2005. These sales increases were primarily due to increased demand for our microcontroller products in end markets, driven principally by market share gains and those factors described on page 22 above. The end markets that we serve include the consumer, automotive, industrial control, communications and computing markets.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller products have remained relatively constant over time due to the proprietary nature of these products. We have experienced, and expect to continue to experience, moderate pricing pressure in certain microcontroller product lines, primarily due to competitive conditions. We have been able to in the past, and expect to be able to in the future, moderate average selling price declines in our microcontroller product lines by introducing new products with more features and higher prices. We may be unable to maintain average selling prices for our microcontroller products as a result of increased pricing pressure in the future, which would adversely affect our operating results.

Memory Products

Sales of our memory products accounted for approximately 12.0% of our total net sales for the three-month period ended December 31, 2006 and 11.9% of our total net sales for the nine-month period ended December 31, 2006 compared to approximately 13.3% of our total net sales for the three-month period ended December 31, 2005 and 13.8% of our total net sales in the nine-month period ended December 31, 2005.

Net sales of our memory products decreased approximately 3.9% in the three-month period ended December 31, 2006 compared to the three-month period ended December 31, 2005. Net sales of our memory products decreased approximately 1.1% in the nine-month period ended December 31, 2006 compared to the nine-month period ended December 31, 2005. These sales decreases were driven by market share gains and customer demand conditions within the Serial EEPROM market, which products comprise substantially all of our memory product net sales.

Serial EEPROM product pricing has historically been cyclical in nature, with steep price declines followed by periods of relative price stability, driven by changes in industry capacity at different stages of the business cycle. We have experienced, and expect to continue to experience, varying degrees of competitive pricing pressures in our Serial EEPROM products. We may be unable to maintain the average selling prices of our Serial EEPROM products as a result of increased pricing pressure in the future, which could adversely affect our operating results.

Analog and Interface Products

Sales of our analog and interface products accounted for approximately 8.3% of our total net sales for the three-month period ended December 31, 2006 and 8.0% of our total net sales for the nine-month period ended December 31, 2006 compared to approximately 7.4% of our total net sales for the three-month period ended December 31, 2005 and 6.8% of our total net sales for the nine-month period ended December 31, 2005.

Net sales of our analog and interface products increased approximately 20.1% in the three-month period ended December 31, 2006 and 35.8% in the nine-month period ended December 31, 2006 compared to the three and nine-month periods ended December 31, 2005. These sales increases in our analog and interface products were driven by market share gains and supply and demand conditions within the analog and interface market.

Analog and interface products can be proprietary or non-proprietary in nature. Currently, we consider more than half of our analog and interface product mix to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog and interface business will experience price fluctuations, driven primarily by the current supply and demand for those products. We may be unable to maintain the average selling prices of our analog and interface products as a result of increased pricing pressure in the future, which would adversely affect our operating results. We anticipate the proprietary portion of our analog and interface products will increase over time.

Turns Orders

Our net sales in any given quarter depend upon a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. Historically, we have proven our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with short delivery schedules. Shorter lead times generally mean that turns orders as a percentage of our business are relatively high in any particular quarter and reduce our backlog visibility on future product shipments. Turns orders correlate to overall semiconductor industry conditions and product lead times. Turns orders are difficult to predict, and we may not experience the combination of turns orders and shipments from backlog in a quarter that would be sufficient to achieve anticipated net sales. If we do not achieve a sufficient level of turns orders in a particular quarter, our net sales and operating results may suffer.

Distribution

Distributors accounted for approximately 65% of our net sales in the nine-month period ended December 31, 2006 and approximately 64% of our net sales in the nine-month period ended December 31, 2005.

Our two largest distributors accounted for approximately 21% of our net sales in the nine-month period ended December 31, 2006 and approximately 24% of our net sales in the nine-month period ended December 31, 2005.

Generally, we do not have long-term agreements with our distributors and we, or our distributors, may terminate our relationships with each other with little or no advanced notice. The loss of, or the disruption in the operations of, one or more of our distributors could reduce our future net sales in a given quarter and could result in an increase in inventory returns.

At December 31, 2006, our distributors were maintaining an average of approximately 1.9 months of inventory of our products. Over the past three fiscal years, the months of inventory maintained by our distributors have fluctuated between approximately 1.9 and 2.8 months. Thus, inventory levels at our distributors are at the low end of the range we have experienced over the last three years. As we recognize revenue based on sell through for all of our distributors, we do not believe that inventory holding patterns at our distributors will materially impact our net sales.

Sales by Geography

Sales by geography for the three and nine-month periods ended December 31, 2006 and December 31, 2005 were as follows (dollars in thousands):

	Three Months Ended December 31, (unaudited)				Nine Months Ended December 31, (unaudited)			
	2006	%	2005	%	2006	%	2005	%
Americas	$ 70,072	27.9%	$ 66,143	28.2%	$ 217,280	27.8%	$ 194,085	28.5%
Europe	70,749	28.2%	60,105	25.6%	218,348	27.9%	184,293	27.1%
Asia	110,183	43.9%	108,648	46.2%	345,867	44.3%	302,343	44.4%
Total sales	$ 251,004	100.0%	$ 234,896	100.0%	$ 781,495	100.0%	$ 680,721	100.0%

Our sales to foreign customers have been predominately in Asia and Europe, which we attribute to the manufacturing strength in those areas for automotive, communications, computing, consumer and industrial control products. Americas sales include sales to customers in the United States, Canada, Central America and South America. Sales to customers in Asia have increased over time due to many of our customers transitioning their manufacturing operations to Asia and growth in demand from the emerging Asian market.

Sales to foreign customers accounted for approximately 75% of our net sales in the three-month period ended December 31, 2006 and 74% of our net sales in the three-month period ended December 31, 2005. Sales to foreign customers accounted for 74% of our net sales in the nine-month period ended December 31, 2006 and 73% of our net sales in the nine-month period ended December 31, 2005. Substantially all of our foreign sales are U.S. dollar denominated.

Gross Profit

Our gross profit was $149.7 million in the three months ended December 31, 2006, and $140.3 million in the three months ended December 31, 2005. Our gross profit was $470.2 million in the nine months ended December 31, 2006, and $402.3 million in the nine months ended December 31, 2005. Gross profit as a percent of sales was 59.6% in the three months ended December 31, 2006, and 59.7% in the three months ended December 31, 2005. Gross profit as a percent of sales was 60.2% in the nine months ended December 31, 2006, and 59.1% in the nine months ended December 31, 2005.

The most significant factors affecting our gross profit percentage in the periods covered by this report were:

- increased cost of sales of $1.6 million in the three months ended December 31, 2006 associated with share-based compensation expense under the SFAS 123R;
- fluctuations in the product mix of microcontrollers, proprietary and non-proprietary analog products and Serial EEPROM products resulting in higher average selling prices for our products; and
- continued cost reductions in wafer fabrication and assembly and test manufacturing such as new manufacturing technologies and more efficient manufacturing techniques.

Other factors that impacted gross profit percentage in the periods covered by this report include:

- changes in capacity utilization and absorption of fixed costs;
- gross profit on products sold through the distribution channel;
- depreciation expense as a percentage of cost of sales; and
- inventory write-offs and the sale of inventory that was previously written off.

During the three-month period ended December 31, 2006, we operated at approximately 99% of our Fab 2 capacity, which is approximately the same level of utilization from the same period of the previous fiscal year. Our utilization of Fab 4's total capacity is at relatively low levels although we are utilizing all of the installed equipment base. We expect to maintain approximately the same levels of capacity utilization at Fab 2 and Fab 4 during the fourth quarter of fiscal 2007.

The process technologies utilized impact our gross margins. Fab 2 currently utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 to 1.0 micron processes. At December 31, 2006, Fab 4 predominantly utilized our 0.5 micron process technology. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. All of our production has been on 8-inch wafers for the periods covered by this report.

Our overall inventory levels were $121.9 million at December 31, 2006 compared to $115.0 million at March 31, 2006. We had 110 days of inventory on our balance sheet at December 31, 2006 compared to 106 days at March 31, 2006 and 111 days at December 31, 2005. In the three and nine months ended December 31, 2006, $1.7 million and $5.0 million, respectively, of share-based compensation expense was capitalized to inventory as a result of the adoption of SFAS 123R. The adoption of this accounting standard adversely impacted our gross profit in the quarter ending December 31, 2006, as the inventory including the share-based compensation was sold.

We anticipate that our gross margins will fluctuate over time, driven primarily by the overall product mix of microcontroller, analog and interface and memory products and the percentage of net sales of each of these products in a particular quarter, as well as manufacturing yields, fixed cost absorption, capacity utilization levels, particularly those at Fab 4, and competitive and economic conditions.

At December 31, 2006, approximately 73% of our assembly requirements were being performed in our Thailand facility, compared to approximately 62% as of December 31, 2005. Third-party contractors located in Asia perform the balance of our assembly operations. Substantially all of our test requirements were being performed in our Thailand facility as of December 31, 2006 and December 31, 2005. We believe that the assembly and test operations performed at our Thailand facility provide us with significant cost savings when compared to third-party contractor assembly and test costs, as well as increased control over these portions of the manufacturing process.

We rely on outside wafer foundries for a small portion of our wafer fabrication requirements.

Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. While we review the quality, delivery and cost performance of our third-party contractors, our future operating results could suffer if any third-party contractor is unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.

Research and Development (R&D)

R&D expenses for the three months ended December 31, 2006 were $28.0 million, or 11.2% of sales, compared to $23.4 million, or 10.0% of sales, for the three months ended December 31, 2005. R&D expenses for the nine months ended December 31, 2006 were $85.2 million, or 10.9% of sales, compared to $70.4 million, or 10.3% of sales, for the nine months ended December 31, 2005. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. We expense all R&D costs as incurred. R&D expenses include labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses increased $4.7 million, or 20.0%, for the three months ended December 31, 2006 over the same period last year. R&D expenses increased $14.7 million, or 20.9%, for the nine months ended December 31, 2006 over the same period last year. The primary reasons for the increases in R&D expenses in these periods

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were higher labor costs as a result of expanding our internal R&D headcount, increases in bonuses and $2.4 million and $7.2 million of share-based compensation as a result of the adoption of SFAS 123R in the three and nine months ended December 31, 2006, respectively.

Selling, General and Administrative

Selling, general and administrative expenses for the three months ended December 31, 2006 were $40.2 million, or 16.0% of sales, compared to $32.3 million, or 13.8% of sales, for the three months ended December 31, 2005. Selling, general and administrative expense for the nine months ended December 31, 2006 were $122.5 million, or 15.7% of sales, compared to $95.0 million, or 14.0% of sales, for the nine months ended December 31, 2005. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force and field applications engineers who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses increased $7.9 million, or 24.4%, for the three months ended December 31, 2006 over the same period last year. Selling, general and administrative expenses increased $27.5 million**,** or 28.9%, for the nine months ended December 31, 2006 over the same period last year. The primary reasons for the increases in selling, general and administrative expenses in these periods were higher labor costs as a result of expanding our internal resources involved in the technical aspect of selling our products, increases in bonuses and $2.8 million and $8.2 million of share-based compensation as a result of the adoption of SFAS 123R, in the three and nine-month periods ended December 31, 2006, respectively.

Selling, general and administrative expenses fluctuate over time, primarily due to revenue and operating expense levels.

Other Income (Expense)

Interest income in the three and nine-month periods ended December 31, 2006 increased from interest income in the three and nine-month periods ended December 31, 2005 as our average invested cash balances and the average interest rates on those invested cash balances were at higher levels in the periods ended December 31, 2006 compared to the same periods in the prior fiscal year.

Provision for Income Taxes

Provisions for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings. We had an effective tax rate of 24.0% for the three and nine-month periods ending December 31, 2006 and December 31, 2005.

At December 31, 2006, our gross deferred tax asset was $69.0 million. Our gross deferred tax asset decreased by $9.6 million in the nine months ended December 31, 2006 compared to the level at March 31, 2006, due primarily to increases in income, which allowed us to utilize tax credits, and changes in various temporary differences between our book and tax reporting. At December 31, 2006, our deferred tax liability was $13.2 million. Our gross deferred tax liability decreased by $1.4 million in the nine months ended December 31, 2006 compared to the level at March 31, 2006, due primarily to changes in temporary differences in depreciation between our book and tax reporting.

Our Thailand manufacturing operations currently benefit from numerous tax holidays that have been granted to us by the Thailand government based on our investments in property, plant and equipment in Thailand. Our tax holiday periods in Thailand expire at various times in the future. One of our Thailand tax holidays expired in September 2006 and the expiration did not have a material impact on our effective tax rate. We do not expect the future expiration of any of our tax holiday periods in Thailand to have a material impact on our

effective tax rate. Any expiration of tax holidays are expected to have a minimal impact on our overall tax expense due to other tax holidays and an increase in income in other taxing jurisdictions with lower statutory rates.

Liquidity and Capital Resources

We had $1,264 million in cash, cash equivalents and short-term and long-term investments at December 31, 2006, a decrease of $20.6 million from the March 31, 2006 balance. The decrease in cash, cash equivalents and short-term and long-term investments over this time period is primarily attributable to a $239.5 million pay down of short-term debt offset by cash generated from operating activities.

Net cash provided from operating activities was $357.8 million for the nine-month period ended December 31, 2006 compared to $323.1 million for the nine-month period ended December 31, 2005. The increase in cash flow from operations was primarily from increases in profitability, $19.4 million of additional share-based compensation expenses as a result of the adoption of SFAS 123R, changes in accounts receivable, accounts payable and accrued liability balances, and changes in deferred income on shipments to distributors.

During the nine months ended December 31, 2006, net cash used in investing activities increased $221.9 million, to $436.8 million, from $214.9 million for the nine months ended December 31, 2005. The increase was due primarily to changes in our net purchases, sales and maturities of short-term and long-term investments in the nine months ended December 31, 2006. Capital expenditures were $51.4 million in the nine-month period ended December 31, 2006 compared to $42.8 million in the nine-month period ended December 31, 2005.

We enter into hedging transactions from time to time in an attempt to reduce our exposure to currency rate fluctuations. The amount of the hedges outstanding at December 31, 2006 were immaterial. Although none of the countries in which we conduct significant foreign operations have had a highly inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the nine months ended December 31, 2006 were $51.4 million compared to $42.8 million for the nine months ended December 31, 2005. Capital expenditures are primarily for the expansion of production capacity and the addition of research and development equipment. We currently anticipate spending approximately $60 million to $65 million during the next 12 months to invest in equipment and facilities to maintain, and selectively increase, capacity to meet our currently anticipated needs.

We expect to finance capital expenditures through our existing cash balances and cash flows from operations. We believe that the capital expenditures anticipated to be incurred over the next 12 months will provide sufficient manufacturing capacity to meet our currently anticipated needs.

Net cash used in financing activities was $333.0 million for the nine months ended December 31, 2006 compared to $19.4 million for the nine months ended December 31, 2005. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plan were $42.3 million for the nine months ended December 31, 2006 and $63.5 million for the nine months ended December 31, 2005. We paid cash dividends to our shareholders of $150.5 million in the nine months ended December 31, 2006 and $ 79.6 million in the nine months ended December 31, 2005. During the nine months ended December 31, 2006, we paid down $239.5 million in short-term borrowings, resulting in a short-term borrowing balance of $29.5 million at December 31, 2006. The short-term borrowings related to transactions associated with our repatriation of foreign earnings under the American Jobs Creation Act in fiscal 2006. To complete the repatriation of $500 million, we initiated certain borrowings which were collateralized against investments held in our foreign locations. We presently expect to pay down the short-term borrowings as our investments mature and new cash is generated in

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the foreign locations. Excess tax benefits from share-based payment arrangements were $14.7 million in the nine months ended December 31, 2006.

On April 22, 2004, our Board of Directors authorized the repurchase of 2.5 million shares of our common stock in the open market or in privately negotiated transactions. As of December 31, 2006, we had repurchased 1,004,834 common shares under this authorization for a total of $26.6 million. As of December 31, 2006, all of the purchased shares under the authorization were used to fund stock option exercises and purchases under our employee stock purchase plan. On October 25, 2006, our Board of Directors authorized the repurchase of up to an additional 10 million shares of our common stock in the open market or in privately negotiated transactions. The timing and amount of any future repurchases will depend upon market conditions, interest rates and corporate considerations.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. The initial quarterly dividend of $0.02 per share was paid on December 6, 2003 in the aggregate amount of $4.0 million. We have continued to pay quarterly dividends and have increased the amount of such dividends on a regular basis. A quarterly dividend of $0.25 per share was paid on November 22, 2006 in the aggregate amount of $54.0 million. A quarterly dividend of $0.265 per share was declared on January 31, 2007 and will be paid on February 28, 2007 to shareholders of record as of February 14, 2007. We expect the February 2007 cash dividend to be approximately $57.4 million. During fiscal 2006, we paid dividends in the aggregate amount of $0.57 per share for a total dividend payment of $120.1 million. Since the inception of our dividend program, we have paid aggregate dividends of $345.1 million.

We believe that our existing sources of liquidity combined with cash generated from operations will be sufficient to meet our currently anticipated cash requirements for at least the next 12 months. However, the semiconductor industry is capital intensive. In order to remain competitive, we must constantly evaluate the need to make significant investments in capital equipment for both production and research and development. We may seek additional equity or debt financing from time to time to maintain or expand our wafer fabrication and product assembly and test facilities, or for other purposes. The timing and amount of any such financing requirements will depend on a number of factors, including demand for our products, changes in industry conditions, product mix, and competitive factors. There can be no assurance that such financing will be available on acceptable terms, and any additional equity financing would result in incremental ownership dilution to our existing stockholders.

Contractual Obligations

There have not been any material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2006.

Off-Balance Sheet Arrangements

As of December 31, 2006, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Recently Issued Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”). FIN 48 is an interpretation of FASB Statement No. 109, “Accounting for Income Taxes,” and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective for us as of the beginning fiscal 2008. We are currently evaluating the impact, if any, that FIN 48 will have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact, if any, that SFAS 157 will have on our financial statements.

In September 2006, the FASB issued SFAS 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)” (“SFAS 158”) and is effective for our fiscal year ended March 31, 2007. This standard requires companies to recognize, on a prospective basis, the funded status of their defined benefit pension and other postretirement benefit plans as a net liability or asset on their balance sheets. We are currently evaluating the impact, if any, that SFAS 158 will have on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our investment portfolio, consisting of fixed income securities and money market funds that we hold on an available-for-sale basis, was $1.3 billion as of December 31, 2006. This amount includes securities with original maturities that are within 90 days when acquired and are classified as cash and cash equivalents on our balance sheet. The securities in our investment portfolio, like all fixed income instruments, are subject to interest rate and credit risk and will decline in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize any material adverse impact in income or cash flows if market interest rates increase. The following table provides information about our available-for-sale securities that are sensitive to changes in interest rates. We have aggregated our available-for-sale securities for presentation purposes since they are all very similar in nature (dollars in thousands):

	Financial instruments mature during the fiscal year ended March 31,					
	2007	2008	2009	2010	2011	Thereafter
Available-for-sale securities	$ 191,661	$ 219,004	$ 203,302	$ 222,791	$ 45,491	$ 229,035
Weighted-average yield rate	4.96%	3.68%	3.85%	4.29%	5.76%	5.34%

We have international operations and are thus subject to foreign currency rate fluctuations. To date, our exposure related to exchange rate volatility has not been significant. Approximately 99% of our sales are denominated in U.S. dollars. At times we maintain hedges of foreign currency exposure of a net investment in a foreign operation. We had no foreign currency hedges outstanding as of December 31, 2006. If foreign currency rates fluctuate by 15% from the rates at December 31, 2006, the effect on our financial position and results of operation would not be material.

During the normal course of business we are routinely subjected to a variety of market risks, examples of which include, but are not limited to, interest rate movements and foreign currency fluctuations, as we discuss in this Item 3, and collectability of accounts receivable. We continuously assess these risks and have established policies and procedures to protect against the adverse effects of these and other potential exposures. Although we do not anticipate any material losses in these risk areas, no assurance can be made that material losses will not be incurred in these areas in the future.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Securities Exchange Act of 1934, as amended, we evaluated under the

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supervision of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

Changes in Internal Control over Financial Reporting

During the three months ended December 31, 2006, there was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. Although the outcome of these actions is not presently determinable, we believe that the ultimate resolution of these matters will not harm our business and will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation relating to the semiconductor industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

Item 1A. Risk Factors

When evaluating Microchip and its business, you should give careful consideration to the factors listed below, in addition to the information provided elsewhere in this Form 10-Q and in other documents that we file with the Securities and Exchange Commission.

Our quarterly operating results may fluctuate due to factors that could reduce our net sales and profitability.

Our quarterly operating results are affected by a wide variety of factors that could reduce our net sales and profitability, many of which are beyond our control.

Some of the factors that may affect our quarterly operating results include:

- changes in demand or market acceptance of our products and products of our customers
- levels of inventories at our customers
- the mix of inventory we hold and our ability to satisfy orders from our inventory
- changes in utilization of our manufacturing capacity and fluctuations in manufacturing yields
- our ability to secure sufficient assembly and testing capacity
- availability of raw materials and equipment

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- competitive developments including pricing pressures
- the level of orders that are received and can be shipped in a quarter
- the level of sell-through of our products through distribution
- changes or fluctuations in customer order patterns and seasonality
- ability to timely introduce products
- constrained availability from other electronic suppliers impacting our customers' ability to ship their products, which in turn may adversely impact our sales to those customers
- costs and outcomes of any current or future tax audits or any litigation involving intellectual property, customers or other issues
- disruptions in our business or our customers' businesses due to terrorist activity, armed conflict, war, worldwide oil prices and supply, public health concerns or disruptions in the transportation system
- property damage or other losses which are not covered by insurance
- general economic, industry or political conditions in the United States or internationally

We believe that period-to-period comparisons of our operating results are not necessarily meaningful and that you should not rely upon any such comparisons as indications of future performance. In future periods our operating results may fall below our public guidance or the expectations of public market analysts and investors, which would likely have a negative effect on the price of our common stock.

Our operating results will suffer if we ineffectively utilize our manufacturing capacity or fail to maintain manufacturing yields.

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used, the performance of our wafer fabrication personnel and equipment, and other quality issues. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at approximately the current levels. This could include delays in the recognition of revenue, loss of revenue or future orders, and customer-imposed penalties for failure to meet contractual shipment deadlines.

Our operating results are also adversely affected when we operate at less than optimal capacity. Lower capacity utilization results in certain costs being charged directly to expense and lower gross margins.

We are dependent on orders that are received and shipped in the same quarter and therefore limited in our visibility of future product shipments.

Our net sales in any given quarter depend upon a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. We measure turns orders at the beginning of a quarter based on the orders needed to meet the shipment targets that we set entering the quarter. Historically, we have proven our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with relatively short delivery schedules. Shorter lead times generally mean that turns orders as a percentage of our business are relatively high in any particular quarter and reduces our backlog visibility on future product shipments. Turns orders correlate to overall semiconductor industry conditions and product lead times. Because turns orders are difficult to predict, varying levels of turns orders make our net sales more difficult to forecast. If we do not achieve a sufficient level of turns orders in a particular quarter relative to our revenue targets, our revenue and operating results may suffer.

Intense competition in the markets we serve may lead to pricing pressures, reduced sales of our products or reduced market share.

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources with which to pursue engineering, manufacturing, marketing and distribution of their products. We may be unable to compete successfully in the future, which could harm our business.

Our ability to compete successfully depends on a number of factors both within and outside our control, including, but not limited to:

- the quality, performance, reliability, features, ease of use, pricing and diversity of our products
- our success in designing and manufacturing new products including those implementing new technologies
- the rate at which customers incorporate our products into their own applications
- product introductions by our competitors
- the number, nature and success of our competitors in a given market
- our ability to obtain adequate supplies of raw materials and other supplies at acceptable prices
- our ability to protect our products and processes by effective utilization of intellectual property rights
- the quality of our customer service and our ability to address the needs of our customers, and
- general market and economic conditions.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller and proprietary analog and interface products have remained relatively constant, while average selling prices of our Serial EEPROM and non-proprietary analog and interface products have declined over time.

We have experienced, and expect to continue to experience, modest pricing declines in certain of our more mature proprietary product lines, due primarily to competitive conditions. We have been able to moderate average selling price declines in many of our proprietary product lines by continuing to introduce new products with more features and higher prices. We have experienced in the past and expect to continue to experience in the future varying degrees of competitive pricing pressures in our Serial EEPROM products.

We may be unable to maintain average selling prices for our products as a result of increased pricing pressure in the future, which could adversely impact our operating results.

Our business is dependent on selling through distributors.

Sales through distributors accounted for 65% of our net sales in fiscal 2006 and during the first nine months of fiscal 2007. Our two largest distributors together accounted for approximately 24% of our net sales in fiscal 2006, and 21% of our net sales in the first nine months of fiscal 2007. We do not have long-term agreements with our distributors and both we and our distributors may each terminate our relationship with little or no advanced notice. We believe that customers recognize Microchip for its products and brand name and use distributors as an effective supply channel.

During fiscal 2006, we reduced the gross margin that certain of our distributors earn when they sell our products. We reduced these distributors' gross margins because we believe these distributors did not have sufficient technical sales resources to properly address the marketplace for our products. We have added a significant number of technical sales employees throughout our worldwide sales organization to address the support requirements for both our OEM and distribution customers. We cannot predict the impact, if any, that our actions will have on our relationships with such distributors.

The loss of, or a disruption in the operations of, one or more of our distributors could reduce our net sales in a given period and could result in an increase in inventory returns.

Our success depends on our ability to introduce new products on a timely basis.

Our future operating results will depend on our ability to timely develop and introduce new products that compete on the basis of price and performance and fulfill customer requirements. The success of our new product introductions depends on various factors, including, but not limited to:

- proper new product selection
- timely completion and introduction of new product designs
- development of support tools and collateral literature that make complex new products easy for engineers to understand and use
- our ability to ramp new products to volume production, and
- market acceptance of our customers' end products.

Because our products are complex, we have experienced delays from time to time in completing development of new products. In addition, our new products may not receive or maintain substantial market acceptance. We may be unable to timely design, develop and introduce competitive products, which could adversely impact our future operating results.

Our success also depends upon our ability to develop and implement new design and process technologies. Semiconductor design and process technologies are subject to rapid technological change and require significant R&D expenditures. We and other companies in the industry have, from time to time, experienced difficulties in effecting transitions to advanced process technologies and, consequently, have suffered reduced manufacturing yields or delays in product deliveries. Our future operating results could be adversely affected if any transition to future process technologies is substantially delayed or inefficiently implemented.

We must attract and retain qualified personnel to be successful, and competition for qualified personnel is intense in our market.

Our success depends upon the efforts and abilities of our senior management, engineering and other personnel. The competition for qualified engineering and management personnel is intense. We may be unsuccessful in retaining our existing key personnel or in attracting and retaining additional key personnel that we require. The loss of the services of one or more of our key personnel or the inability to add key personnel could harm our business. Our employees' and officers' employment is at will.

We are dependent on several contractors to perform key manufacturing functions for us.

We use several contractors located in Asia for a portion of the assembly and testing of our products. We also rely on outside wafer foundries for a portion of our wafer fabrication. Although we own the majority of our manufacturing resources, the disruption or termination of any of our contractors could harm our business and operating results.

Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. Our future operating results could suffer if any contractor were to experience financial, operations or production difficulties or situations when demand exceeds capacity, or if they were unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels, or if due to their locations in foreign countries they were to experience political upheaval or infrastructure disruption. Further, procurement from third parties is done by purchase order and contracts. If these third parties are unable or unwilling to timely deliver products or services conforming to our quality standards, we may not be able to qualify additional manufacturing sources for our products in a timely manner or at all, and such arrangements, if any, may not be on favorable terms to us. In such event, we could experience an interruption in production, an increase in manufacturing and production costs, or a decline in product reliability, and our business and operating results could be adversely affected.

We may lose sales if our suppliers of raw materials and equipment fail to meet our needs.

Our semiconductor manufacturing operations require raw materials and equipment that must meet exacting standards. We generally have more than one source for these supplies, but there are only a limited number of suppliers capable of delivering various raw materials and equipment that meet our standards. The raw materials and equipment necessary for our business could become more difficult to obtain as worldwide use of semiconductors in product applications increases. We have experienced supply shortages from time to time in the past, and on occasion our suppliers have told us they need more time than expected to fill our orders or that they will no longer support certain equipment with updates or spare and replacements parts. An interruption of any raw materials or equipment sources, or the lack of supplier support for a particular piece of equipment, could harm our business.

Our operating results may be impacted by both seasonality and the wide fluctuations of supply and demand in the semiconductor industry.

The semiconductor industry is characterized by seasonality and wide fluctuations of supply and demand. Since a significant portion of our revenue is from consumer markets and international sales, our business may be subject to seasonally lower revenues in the third and fourth quarters of our fiscal year. However, broad strength in our overall business in recent periods has had a more significant impact on our results than seasonality, and has made it difficult to assess the impact of seasonal factors on our business. The industry has also experienced significant economic downturns, characterized by diminished product demand and production over-capacity. We have sought to reduce our exposure to this industry cyclicality by selling proprietary products that cannot be easily or quickly replaced, to a geographically diverse base of customers across a broad range of market segments. However, we have experienced substantial period-to-period fluctuations in operating results and expect, in the future, to experience period-to-period fluctuations in operating results due to general industry or economic conditions.

We are exposed to various risks related to legal proceedings or claims.

We are currently, and in the future may be, involved in legal proceedings or claims regarding patent infringement, intellectual property rights, contracts and other matters. As is typical in the semiconductor industry, we receive notifications from customers from time to time who believe that we owe them indemnification or other obligations related to infringement claims made against the customers by third parties. These legal proceedings and claims, whether with or without merit, could result in substantial cost to us and divert our resources. If we are not able to defend, resolve or settle a claim, obtain necessary licenses on commercially reasonable terms, reengineer our products or processes to avoid infringement, we could incur uninsured liability in any of them, need to take an appropriate charge to operations, be enjoined from selling a material portion of our product line or using certain processes, suffer a reduction or elimination in value of inventories, and as a result, our business, financial condition or results of operations could be harmed.

It is also possible that from time to time we may be subject to warranty or product liability claims that could lead to significant expenses related to the defense of such claims, increased costs associated with the replacement of affected products, and a requirement to pay damages claims. Because the systems into which our products are integrated have a higher cost of goods than the products we sell, these expenses and damages may be significantly higher than the sales and profits we received from the products involved. While we specifically exclude consequential damages in our standard terms and conditions, our ability to avoid such liabilities may be limited by applicable law. We do have general liability insurance, but it is unlikely that such insurance will cover all claims or be of a sufficient amount to fully protect against such claims. Costs or payments we may make in connection with warranty or product liability claims may adversely affect our results of operations.

Further, we sell to customers in industries such as automotive, aerospace, and medical, where failure of their systems could cause damage to property or persons. We may be subject to product liability claims if our products cause the system failures. Based on our historical experience, we believe that our risk of exposure to product liability claims is currently low. However, we will face increased exposure to product liability claims if there are substantial increases in either the volume of our sales into these applications or the frequency of system failures caused by our devices.

Our failure to adequately protect our intellectual property could result in lost revenue or market opportunities.

Our ability to obtain patents, licenses and other intellectual property rights covering our products and manufacturing processes is important for our success. To that end, we have acquired certain patents and patent licenses and intend to continue to seek patents on our inventions and manufacturing processes. The process of seeking patent protection can be long and expensive, and patents may not be issued from currently pending or future applications. In addition, our existing patents and any new patents that are issued may not be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. We may be subject to, or may ourselves initiate, interference proceedings in the U.S. Patent and Trademark Office which can require significant financial and management resources. In addition, the laws of certain foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States. Infringement of our intellectual property rights by a third party could result in uncompensated lost market and revenue opportunities for us.

We do not typically have long-term contracts with our customers.

We do not typically enter into long-term contracts with our customers and we cannot be certain about future order levels from our customers. When we do enter into customer contracts, the contract is generally cancelable at the convenience of the customer. Even though we have over 55,000 end customers and our ten largest customers make up less than 15% of our total revenue, cancellation or modification of long-term and short-term customer contracts could have an adverse financial impact on our revenue and profits.

Further, as the practice has become more commonplace in the industry, we have entered into contracts with certain customers that differ from our standard terms of sale. Under these contracts we commit to supply quantities of products on scheduled delivery dates. If we become unable to supply the customer as required under the contract, the customer may incur additional production costs, lost revenues due to subsequent delays in their own manufacturing schedule, or quality related issues. Under these contracts, we may be liable for the costs the customer has incurred. While we try to limit such liabilities, if they should arise, there may be a material adverse impact on our results of operation and financial condition.

Business interruptions could harm our business.

Operations at any of our manufacturing facilities, or at any of our wafer fabrication or test and assembly subcontractors, may be disrupted for reasons beyond our control, including work stoppages, power loss, incidents of terrorism or security risk, political instability, public health issues, telecommunications, transportation or other infrastructure failure, fire, earthquake, floods, or other natural disasters. If operations at any of our facilities, or our subcontractors' facilities are interrupted, we may not be able to shift production to other facilities on a timely basis. If this occurs, we would likely experience delays in shipments of products to our customers and alternate sources for production may be unavailable on acceptable terms. This could result in reduced revenues and profits and the cancellation of orders or loss of customers. In addition, business interruption insurance will likely not be enough to compensate us for any losses that may occur and any losses or damages incurred by us as a result of business interruptions could significantly harm our business.

We are highly dependent on foreign sales and operations, which exposes us to foreign political and economic risks.

Sales to foreign customers account for a substantial portion of our net sales. During fiscal 2006 and the first nine months of fiscal 2007, approximately 74% of our net sales were made to foreign customers. We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own product assembly and testing facilities located near Bangkok, Thailand. We also use various foreign contractors for a portion of our assembly and testing and for a portion of our wafer fabrication requirements. Substantially all of our finished goods inventory is maintained in Thailand. Although we did not suffer any material disruption in our business as a result of the recent military coup in Thailand, there can be no assurance that similar events in the future in Thailand or other countries will not adversely impact our operations.

Our reliance on foreign operations, foreign suppliers, maintenance of substantially all of our finished goods in inventory at foreign locations and significant foreign sales exposes us to foreign political and economic risks, including, but not limited to:

- political, social and economic instability
- trade restrictions and changes in tariffs
- import and export license requirements and restrictions
- difficulties in staffing and managing international operations
- employment regulations
- disruptions in international transport or delivery
- fluctuations in currency exchange rates
- difficulties in collecting receivables
- public health conditions
- economic slowdown in the worldwide markets served by us, and
- potentially adverse tax consequences.

If any of these risks materialize, our sales could decrease and our operating results could suffer.

Interruptions in information technology systems could adversely affect our business.

We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. Any significant system or network disruption, including but not limited to computer viruses, security breaches, or energy blackouts could have a material adverse impact on our operations, sales and operating results. We have implemented measures to manage our risks related to such disruptions, but such disruptions could negatively impact our operations and financial results. In addition, we may incur additional costs to remedy the damages caused by these disruptions or security breaches.

The occurrence of events for which we are self-insured, or which exceed our insurance limits, may adversely affect our profitability and liquidity.

We have insurance contracts with independent insurance companies related to many different types of risk. However, we self-insure for some risks and obligations. In these circumstances, we have determined that it is more cost effective to self-insure these risks than to pay the increased premium costs in place since the disruption in the insurance market after the events of September 11, 2001. The risks and exposures that we self-insure include product defects, political risks and patent infringement. Should there be a loss or adverse judgment or other decision in an area for which we are self-insured, then our financial condition, result of operations and liquidity may be adversely affected.

We are subject to stringent environmental regulations, which may force us to incur significant expenses.

We must comply with many different federal, state, local and foreign governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing process. Although we believe that our activities conform to presently applicable environmental regulations, our failure to comply with present or future regulations could result in the imposition of fines, suspension of production or a cessation of operations. Any such environmental regulations could require us to acquire costly equipment or to incur other significant expenses to comply with such regulations. Our failure to control the use of or adequately restrict the discharge of hazardous substances could subject us to future liabilities.

Compliance with future changes to securities laws and related regulations could result in increased costs to us.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules enacted and proposed by the Securities and Exchange Commission (SEC), The NASDAQ Stock Market® (NASDAQ) and the New York Stock Exchange (NYSE), resulted in significantly increased costs to us in fiscal 2005 as we responded to their requirements. In particular, complying with the internal control audit requirements of Sarbanes-Oxley Section 404 in fiscal 2005 resulted in increased internal efforts and significantly higher fees from our independent accounting firm. In fiscal 2006, our costs associated with these activities were at approximately the same levels as in fiscal 2005. We expect our fiscal 2007 costs associated with these activities to be at approximately the same levels as in fiscal 2006. Further changes in applicable legal or accounting requirements could result in additional costs in future periods.

Our fiscal 2006 report on Form 10-K contained a report by our management on our internal control over financial reporting including an assessment of the effectiveness of our internal control over financial reporting as of March 31, 2006. Our fiscal 2006 Form 10-K also contained an attestation and report by our auditors with respect to our management's assessment of the effectiveness of internal control over financial reporting under Section 404. While these assessments and reports did not reveal any material weaknesses in our internal control over financial reporting, compliance with Section 404 is an ongoing process and will be required for each future fiscal year. We expect that the ongoing compliance with Section 404 will continue to be both very costly and very challenging and there can be no assurance that material weaknesses with not be identified in future periods. Any adverse results from such ongoing compliance efforts could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Recent regulations related to equity compensation may adversely affect our ability to attract and retain key personnel and have adversely affected our earnings.

From our inception through fiscal 2006, we have used stock options and other long-term equity incentives as a fundamental component of our employee compensation packages and have accounted for them using the intrinsic value method of APB No. 25, "Accounting for Stock Issued to Employees." We believe that stock options and other long-term equity incentives directly motivate our employees to maximize long-term stockholder value and, through the use of vesting, encourage employees to remain with Microchip. In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payments," ("SFAS 123R") which changed U.S. Generally Accepted Accounting Principles in such a way to require us to record a charge to earnings for the fair value of employee stock option grants and other share based compensation beginning in the first quarter of fiscal 2007. This regulation has negatively impacted our earnings for those share based awards that vest in fiscal 2007 and later years. Furthermore, adoption of SFAS 123R required us to make certain assumptions and judgments in the valuation of stock options that we may grant in the future. A change in any of those assumptions or judgments could change the compensation expense that is charged against our earnings and, consequently, adversely affect our results of operations. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or assume unvested equity awards in connection with acquisitions. See also Note 3 to the Condensed Consolidated Financial Statements - Share-Based Compensation.

In addition, recent NASDAQ regulations requiring shareholder approval for all stock option plans as well as recent NYSE regulations prohibiting NYSE member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given voting instructions could make it more difficult for us to grant equity-based awards to employees in the future. To the extent that these or other new regulations make it more difficult or expensive to grant equity incentives to employees, we may incur compensation costs, productivity losses, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors.

The market price of our common stock has fluctuated significantly in the past and is likely to fluctuate in the future. The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors, many of which are beyond our control, including:

- quarterly variations in our operating results and the operating results of other technology companies
- actual or anticipated announcements of technical innovations or new products by us or our competitors
- changes in analysts' estimates of our financial performance or buy/sell recommendations
- changes in our financial guidance or our failure to meet such guidance
- general conditions in the semiconductor industry, and
- worldwide economic and financial conditions.

In addition, the stock market has experienced significant price and volume fluctuations that have particularly affected the market prices for many high technology companies and that often have been unrelated to the operating performance of such companies. These broad market fluctuations and other factors may harm the market price of our common stock.

The outcome of currently ongoing and future audits of our income tax returns by the IRS could have an adverse effect on our results of operations.

We are subject to continued examination of our income tax returns by the Internal Revenue Service and other domestic and international tax authorities. We are currently under audit by the United States Internal Revenue Service ("IRS") for our fiscal years ended March 31, 1998, 1999, 2000 and 2001. As part of this ongoing audit, the IRS has proposed certain adjustments related to positions reflected on these returns. The IRS has issued formal assessments for these adjustments. We do not agree with these adjustments and are appealing these assessments. The IRS is also currently auditing our fiscal years ended March 31, 2002, 2003 and 2004. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuing examinations will not have an adverse effect on future operating results.

In the event we make acquisitions, we may not be able to successfully integrate such acquisitions or attain the anticipated benefits.

While acquisitions do not represent a major part of our growth strategy, from time to time we may consider financially attractive and strategic acquisitions. Any transactions that we complete may involve a number of risks, including the diversion of our management's attention from our existing business to integrate the operations and personnel of the acquired business or possible adverse effects on our operating results during the integration process. In addition, we may not be able to successfully or profitably integrate, operate, maintain and

manage any newly acquired operations or employees or maintain uniform standards, controls, procedures and policies, and this may lead to operational inefficiencies.

Item 6. Exhibits

3.1	Amended and Restated Bylaws amended through January 29, 2007 (incorporated by reference to an exhibit filed with our Form 8-K filed January 31, 2007)
4.1	First Amendment to Rights Agreement dated January 29, 2007
10.1	Change of Control Severance Agreement (incorporated by reference to an exhibit filed with our Form 8-K filed October 27, 2006)
10.2	Change of Control Severance Agreement (incorporated by reference to an exhibit filed with our Form 8-K filed October 27, 2006)
10.3	2004 Equity Incentive Plan as amended and restated (incorporated by reference to an exhibit filed with our Form 8-K filed August 24, 2006)
10.4	Executive Management Incentive Compensation Plan (incorporated by reference to an exhibit filed with our Form 8-K filed August 24, 2006)
10.5	Discretionary Executive Management Incentive Compensation Plan (incorporated by reference to an exhibit filed with our Form 8-K filed August 24, 2006)
10.6	Management Incentive Compensation Plan (incorporated by reference to an exhibit filed with our Form 8-K filed August 24, 2006)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MICROCHIP TECHNOLOGY INCORPORATED

Date: February 6, 2007

By: /s/ Gordon W. Parnell
Gordon W. Parnell
Vice President and Chief Financial Officer
(Duly Authorized Officer, and
Principal Financial and Accounting Officer)