

DIALOG SEMICONDUCTOR PLC

Form 20-F/A

March 12, 2004

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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 12, 2004

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON D.C. 20549

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**AMENDMENT No. 1 TO FORM 20-F**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended DECEMBER 31, 2003

COMMISSION FILE NUMBER 5-59311

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**DIALOG SEMICONDUCTOR PLC**

(Exact name of Registrant as specified in its charter)

NOT APPLICABLE

ENGLAND AND WALES

(Translation of Registrant's Name Into English) (Jurisdiction of Incorporation of Organization)

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Neue Strasse 95  
D-73230 Kirchheim/Teck-Nabern, Germany  
(Address of Principal Executive Offices)

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

NONE

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

<b>TITLE OF EACH CLASS</b>	<b>NAME OF EACH EXCHANGE OF WHICH REGISTERED</b>
ORDINARY SHARES OF £0.10 PER SHARE REPRESENTED BY AMERICAN DEPOSITARY SHARES	NASDAQ NATIONAL MARKET
ORDINARY SHARES	FRANKFURT STOCK EXCHANGE

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

NONE

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

ORDINARY SHARES 4,068,930

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

Yes  No

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

Item 17  Item 18

This Amendment No. 1 is being filed due to an electronic transmission error that occurred during the filing of Form 20-F, which resulted in Notes 8 through 20 to the Consolidated Financial Statements being omitted from Item 18. Accordingly, we include in this amendment Item 18 in its entirety.

## Item 18. Financial Statements

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See the Consolidated Financial Statements and the Notes thereto.

### **SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F, and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

DIALOG SEMICONDUCTOR PLC

Date: March 12, 2004

By: /s/ Roland Pudelko

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Roland Pudelko

Executive Director, Chief Executive Officer and President

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## FINANCIAL INFORMATION

### Audited Consolidated Financial Statements:

#### Independent Auditors Report

#### Consolidated Statements of Operations for the years ended December 31, 2003, 2002 and 2001

#### Consolidated Balance Sheets as of December 31, 2003 and 2002

#### Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001

#### Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss) for the years ended December 31, 2003, 2002 and 2001

#### Consolidated Fixed Assets Schedule

#### Notes to the Consolidated Financial Statements

### EXHIBIT 12.1

#### **RULE 13A-14(A) CERTIFICATION IN ACCORDANCE WITH SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Roland Pudelko, Executive Director, Chief Executive Officer and President of Dialog Semiconductor Plc (the Company ), certify that:

1. I have reviewed this annual report on Form 20-F of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the

Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

Date: March 12, 2004

/s/ Roland Pudelko

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Roland Pudelko

Executive Director, Chief Executive Officer and President

**EXHIBIT 12.2**

**RULE 13A-14(A) CERTIFICATION IN ACCORDANCE WITH SECTION 302 OF THE SARBANES OXLEY ACT OF 2002**

I, Martin Kloeble, Vice President of Finance and Controlling of Dialog Semiconductor Plc (the Company), certify that:

1. I have reviewed this annual report on Form 20-F of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by

this report based on such evaluation; and

c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: March 12, 2004

/s/ Martin Kloeble

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Martin Kloeble

Vice President of Finance and Controlling

### **EXHIBIT 13.1**

#### **SECTION 1350 CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002\***

In connection with the annual report of Dialog Semiconductor Plc (the Company) on Form 20-F for the period ending December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Roland Pudelko, Executive Director, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report containing the financial statements of the Company fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 12, 2004

/s/ Roland Pudelko

Roland Pudelko

Executive Director, Chief Executive Officer and President

\* A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

## **EXHIBIT 13.2**

### **SECTION 1350 CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002\***

In connection with the annual report of Dialog Semiconductor Plc (the Company) on Form 20-F for the period ending December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Martin Kloeble, Vice President of Finance and Controlling of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report containing the financial statements of the Company fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 12, 2004

/s/ Martin Kloeble

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Martin Kloeble

Vice President of Finance and Controlling

\* A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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## **Independent Auditors' Report**

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#### **To the Board of Directors Dialog Semiconductor Plc:**

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

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

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

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

Stuttgart, February 17, 2004  
KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Helwig	Kiechle
Wirtschaftsprüfer	Wirtschaftsprüfer

## Consolidated Financial Statements

### Consolidated Statements of Operations

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(in thousands, except per share data)	Notes	Year ended December 31,			
		2003	2003	2002	2001
Revenues	19	\$ 117,017	€ 92,893	€ 77,104	€ 100,519
Cost of sales	9	(78,572)	(62,374)	(57,409)	(80,574)
<b>Gross margin</b>		<b>38,445</b>	<b>30,519</b>	<b>19,695</b>	<b>19,945</b>
Selling and marketing expenses		(5,287)	(4,197)	(4,149)	(4,054)
General and administrative expense		(6,354)	(5,044)	(6,447)	(5,569)
Research and development		(38,534)	(30,590)	(34,530)	(31,256)
Amortization of goodwill and intangible assets		(2,611)	(2,073)	(1,975)	(3,202)
Restructuring and related impairment charges	3	(2,317)	(1,839)		
<b>Operating loss</b>		<b>(16,658)</b>	<b>(13,224)</b>	<b>(27,406)</b>	<b>(24,136)</b>
Interest income, net		954	757	1,121	898
Foreign currency exchange gains and losses, net	4	(572)	(454)	(1,918)	1,713
Recovery (write-down) of investment	5	397	315	11,969	(42,405)
<b>Result before income taxes</b>		<b>(15,879)</b>	<b>(12,606)</b>	<b>(16,234)</b>	<b>(63,930)</b>
Income tax (expense) benefit	4, 6	(9,843)	(7,814)	6,026	22,544
<b>Net loss</b>		<b>(25,722)</b>	<b>(20,420)</b>	<b>(10,208)</b>	<b>(41,386)</b>

<b>Loss per share:</b>					
Basic and diluted		(0.58)	(0.46)	(0.23)	(0.94)
<b>Weighted average number of shares (in thousands):</b>					
Basic and diluted		43,951	43,951	43,888	43,788

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

## Consolidated Balance Sheets

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



Employee stock purchase plan shares		(33)	(26)	(49)
<b>Net Shareholders equity</b>		<b>159,786</b>	<b>126,843</b>	<b>147,495</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>		<b>176,953</b>	<b>140,471</b>	<b>166,073</b>

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

## Consolidated Statements of Cash Flows

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

<b>Cash provided by financing activities</b>	<b>47</b>	<b>37</b>	<b>14</b>	<b>63</b>
<b>Cash provided by (used for) operating, investing and financing activities</b>	<b>(28,593)</b>	<b>(22,699)</b>	<b>(1,492)</b>	<b>2,574</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(249)	(197)	(129)	173
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(28,842)</b>	<b>(22,896)</b>	<b>(1,621)</b>	<b>2,747</b>
Cash and cash equivalents at beginning of period	39,057	31,005	32,626	29,879
<b>Cash and cash equivalents at end of period</b>	<b>10,215</b>	<b>8,109</b>	<b>31,005</b>	<b>32,626</b>

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

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

#### Index of financial statements

(in thousands of €)	Accumulated other comprehensive loss							Employee stock purchase plan shares	Total
	Ordinary Shares	Additional paid-in capital	Retained earnings (accumulated deficit)	Currency translation adjustment	Available for sale securities	Derivative financial instruments			
<b>Balance at December 31, 2000</b>	<b>6,737</b>	<b>168,776</b>	<b>24,335</b>	<b>(440)</b>			<b>(121)</b>	<b>199,287</b>	
Net loss			(41,386)					(41,386)	
Other comprehensive income (loss)				170		(42)		128	
<b>Total comprehensive loss</b>								<b>(41,258)</b>	
Cost of issuance of shares in 2000		(6)						(6)	
Sale of employee stock purchase plan shares		18					51	69	
<b>Balance at December 31, 2001</b>	<b>6,737</b>	<b>168,788</b>	<b>(17,051)</b>	<b>(270)</b>		<b>(42)</b>	<b>(70)</b>	<b>158,092</b>	
Net loss			(10,208)					(10,208)	
Other comprehensive loss				(287)		(116)		(403)	

<b>Total comprehensive loss</b>								<b>(10,611)</b>
Cost of issuance of shares in 2000		(44)						(44)
Sale of employee stock purchase plan shares		37					21	58
<b>Balance at December 31, 2002</b>	<b>6,737</b>	<b>168,781</b>	<b>(27,259)</b>	<b>(557)</b>		<b>(158)</b>	<b>(49)</b>	<b>147,495</b>
Net loss			(20,420)					(20,420)
Other comprehensive income (loss)				(366)	(61)	158		(269)
<b>Total comprehensive loss</b>								<b>(20,689)</b>
Sale of employee stock purchase plan shares		14					23	37
<b>Balance at December 31, 2003</b>	<b>6,737</b>	<b>168,795</b>	<b>(47,679)</b>	<b>(923)</b>	<b>(61)</b>		<b>(26)</b>	<b>126,843</b>

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

### Consolidated Fixed Assets Schedule

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	Acquisition costs						Balance at December 31, 2003
	Balance at January 1, 2003	Currency change	Additions	Reclassifications	Disposals		
Test equipment	50,283	(17)	3,190	10	(416)	53,050	
Leasehold improvements	1,710	(82)	15		(740)	903	
Office and other equipment	14,048	(431)	2,429	(10)	(1,733)	14,303	
Advance payment relating to test equipment			267			267	
<b>Property, plant and equipment</b>	<b>66,041</b>	<b>(530)</b>	<b>5,901</b>		<b>(2,889)</b>	<b>68,523</b>	

Software, licenses and other	10,450	(133)	618		(5)	10,930
Patents	3,008					3,008
<b>Intangible assets</b>	<b>13,458</b>	<b>(133)</b>	<b>618</b>		<b>(5)</b>	<b>13,938</b>
<b>Goodwill</b>	<b>15,736</b>					<b>15,736</b>
<b>Deposits</b>	<b>19,390</b>	<b>(15)</b>			<b>(19,192)</b>	<b>183</b>

**Investments in affiliated companies**

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

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

**Consolidated Fixed Assets Schedule - continued**

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

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

**Notes to the Consolidated Financial Statements**Index of financial statements

(In thousands of €, unless otherwise stated)

**1. General**

### **a) Description of Business**

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

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

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

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

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

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

### **c) Basis of Presentation**

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

## **2. Summary of Significant Accounting Policies**

### **Principles of Consolidation**

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

### **Cash and Cash Equivalents**

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

### **Marketable Securities**

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

### **Inventories**

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

### **Trade Accounts Receivable**

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

### **Other Current Assets**

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

### **Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is charged on a straight-line basis over the estimated useful lives of the assets as follows:

<b>Equipment</b>	<b>Useful life</b>
Test equipment	3 to 5 years
Leasehold improvements	Shorter of useful life or lease term

Equipment	Useful life
Office and other equipment	3 to 13 years

### Leasing

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

### Goodwill and other Intangible Assets

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

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

Goodwill is tested annually for impairment and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent the carrying amount exceeds the asset's fair value. Prior to the adoption of SFAS 142, goodwill and assembled workforce were amortized over their estimated useful life. Amortization expense related to goodwill and assembled workforce was €1,361 for the year ended December 31, 2001. The following table reconciles previously reported net loss as if the provisions of SFAS 142 were in effect in 2001:

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

### Impairment of Long-Lived Assets

The Company adopted SFAS 144 on January 1, 2002. The adoption of SFAS 144 did not affect the Company's financial statements. In accordance with SFAS 144, long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held

and used is measured by a comparison of the carrying amount of an asset or group of assets to future undiscounted net cash flows expected to be generated by the asset or group of assets. If the carrying amount of an asset or group of asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Prior to the adoption of SFAS 144, the Company accounted for its long-lived assets in accordance with SFAS 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*.

### Foreign Currencies

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

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

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

### Revenue Recognition

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

### Product-Related Expenses

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



## Research and Development

Research and development costs are generally expensed as incurred and amounted to €30.590 (2002: €34,530; 2001: €31,256). Research and development costs incurred in connection with customer service contracts are capitalized and then charged to cost of sales when the related service revenue is recognized. Research and development costs charged to customers and included in cost of sales, amounted to approximately to €263 (2002: €987; 2001: €2,683).

## Income Taxes

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

## Stock-Based Compensation

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

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

## Derivative Instruments and Hedging Activities

On January 1, 2001, the Company adopted SFAS 133, *Accounting for Derivative Instruments and Certain Hedging Activities* and SFAS 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS 133*. SFAS 133 and SFAS 138 require that all derivative instruments be recorded on the balance sheet at their respective fair values, regardless of the purpose for holding them. Changes in the fair value of derivative

financial instruments are recognized periodically either in income or, in the case of a cash flow hedge, in shareholders equity (as a component of other comprehensive income). In situations where the derivative financial instrument does not qualify for hedge accounting, the Company carries the derivative instrument at its fair value on the balance sheet and recognizes any subsequent changes in fair value in earnings.

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

### **Earnings (Loss) per Share**

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

### **Use of Estimates**

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

### **Recently Issued Accounting Standards**

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

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

## **3. Restructuring and Related Impairment Charges**

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

### **a) Restructuring Charges**

In the first quarter of 2003 the Company decided to close its Swedish subsidiary. Restructuring charges include contractual termination benefits that were paid to 39 employees affected by the closing (€1,076) and a provision for estimated costs that will continue to be incurred under an executory contract for its remaining term without economic

benefit to the Company (€478). The contractual termination benefits were accounted for in accordance with SFAS 88. This provision for costs that will continue to be incurred for the duration of the executory contract is recorded at its estimated fair value in accordance with SFAS 146.

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

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

#### b) Asset Impairment Charges

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

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

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

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

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

#### 6. Income Taxes

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

	<b>Year ended December 31,</b>

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

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

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

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

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

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

Deferred income tax assets and liabilities are summarized as follows:

	At December 31,	
	2003	2002
Property, plant and equipment	196	219
Net operating loss and tax credit carryforwards	24,284	27,400

Liabilities	5,640	
Other	41	94
Valuation allowance	(12,329)	(631)
<b>Deferred tax assets</b>	<b>17,832</b>	<b>27,082</b>
Property, plant and equipment	(1,669)	(2,397)
Receivables	(4)	(38)
Liabilities		(124)
<b>Deferred tax liabilities</b>	<b>(1,673)</b>	<b>(2,559)</b>
<b>Net deferred tax assets (liabilities)</b>	<b>16,159</b>	<b>24,523</b>

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

## 7. Additional Cash Flow Information

The following represents supplemental information with respect to cash flows:

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

## 8. Trade Accounts Receivable, net

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

The allowance for doubtful accounts developed as follows:

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

## 9. Inventories

Inventories are comprised of the following:

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

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

## 10. Marketable Securities

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

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

## 11. Deposits and Prepaid Expenses

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

## 12. Other long-term assets

Information with respect to changes to the company's property, plant and equipment, net, intangible assets, goodwill,

investments and deposits is presented in the consolidated Fixed Asset Schedule included herein.

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

### 13. Intangible assets

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

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

### 14. Accrued Expenses

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

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

### 15. Shareholders' Equity and Comprehensive Income

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

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

	Year ended December 31,		
	2003	2002	2001

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

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

## 16. Stock-based Compensation

### a) Stock option plan

On August 7, 1998, the Company adopted a stock option plan ("Plan") under which employees and directors may be granted from time-to-time, at the discretion of the Board, stock options to acquire up to 3,840,990 shares of the Company's authorized but unissued ordinary shares. On May 16, 2002 the shareholders of the Company approved a resolution increasing the maximum amount of stock options which may be granted by the company to 15%, after issue, of the Company's issued share capital. At December 31, 2003, 15%, after issue, of the Company's issued share capital amounted to 7,776,870. Stock options are granted with an exercise price not less than the estimated fair value at the date of grant. Stock options have terms of ten years and vest over periods of one to five years from the date of grant.

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

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

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

	Year ended December 31,					
	2003		2002		2001	
(prices in €)	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	2,634,382	3.62	2,672,506	3.78	2,849,778	14.01



Granted	2,050,180	3.37	124,060	2.33	1,193,460	6.86
Exercised	(76,828)	0.52	(79,174)	0.79	(159,006)	0.42
Forfeited	(204,004)	6.21	(83,010)	9.78	(145,106)	20.41
Cancelled	(991,460)	7.29			(1,066,620)	32.80
<b>Outstanding at end of year</b>	<b>3,412,270</b>	<b>2.32</b>	<b>2,634,382</b>	<b>3.62</b>	<b>2,672,506</b>	<b>3.78</b>
Options exercisable at year end	1,013,356	0.70	1,217,402	3.07	536,594	0.89

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

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

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

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

#### b) Employee Stock Purchase Plan

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

## 17. Commitments

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

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

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

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

## 18. Derivative Financial Instruments and Hedging Activities

### a) Use of Financial Instruments

The Company's sales are primarily denominated in Euros and US dollars whereas purchases of raw materials and manufacturing services are primarily denominated in US dollars. In order to manage these foreign currency exchange risks, the Company attempts to match cash inflows and outflows (sales with supply costs) in the same currency, primarily the US dollar. In situations where the Company is not able to effectively match cash inflows and outflows in the same currency, management considers the use of derivative financial instruments. As a matter of policy, the Company does not engage in derivatives trading, derivatives market-making or other speculative activities.

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

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

### b) Fair value of financial instruments

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

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

At December 31,							
2003				2002			
	Carrying amount		Fair Value		Carrying amount		Fair Value

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

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

## 19. Segment Reporting

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

Revenues by market sector consisted of the following:

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

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

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

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

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

## **20. Transactions with Related Parties**

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