STMICROELECTRONICS NV
Form 20-F
March 03, 2008

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**As filed with the Securities and Exchange Commission on March 3, 2008**

**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**Form 20-F**

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2007**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**Date of event requiring this shell company report**

**Commission file number: 1-13546**
**STMicroelectronics N.V.**
*(Exact name of registrant as specified in its charter)*

| **Not Applicable** | **The Netherlands** |
|---|---|
| *(Translation of registrant s name into English)* | *(Jurisdiction of incorporation or organization)* |

**39, Chemin du Champ des Filles**
**1228 Plan-Les-Ouates**
**Geneva**
**Switzerland**
*(Address of principal executive offices)*

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

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

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

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

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

**899,760,539 common shares at December 31, 2007**

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

Yes þ No o

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

Yes o No þ

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 þ No o

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

| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
|---|---|---|---|

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

Item 17 o Item 18 þ

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

Yes o No þ

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

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

We have compiled the market share, market size and competitive ranking data in this annual report using statistics and other information obtained from several third-party sources. Except as otherwise disclosed herein, all references to our competitive positions in this annual report are based on 2007 revenues according to provisional industry data published by iSuppli Corporation and 2006 revenues according to industry data published by iSuppli and Gartner, Inc., and references to trade association data are references to World Semiconductor Trade Statistics ( WSTS ). Certain terms used in this annual report are defined in Certain Terms.

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

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

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

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- the closing of the transaction announced in May 2007 with Intel and Francisco Partners concerning the creation of a new independent Flash memory company, which was later named Numonyx, within the timeframe and pursuant to the terms currently planned; as well as any future losses that may be incurred once Numonyx begins operations, which would affect us in proportion to our equity holding in this company;

- our ability to address changes in the exchange rates between the U.S. dollar and the Euro, in particular with the further weakening of the U.S. dollar which impacts our gross margin since our fixed costs are incurred in Euros, when our selling prices are mainly in U.S. dollars as well as changes in the exchange rates between the U.S. dollar and the currencies of the other major countries in which we have our operating infrastructure;

the attainment of anticipated benefits of cooperative research and development alliances and our ability to secure new process technologies in a timely and cost effective manner so that the resultant products can be commercially viable and acceptable in the marketplace;

our ability, in an intensively competitive environment and cyclical industry, to design competitive products, to secure timely acceptance of our products by our customers, to adequately operate our manufacturing facilities at sufficient levels to cover fixed operating costs, and to achieve our pricing expectations for high-volume supplies of new products in whose development we have been, or are currently, investing;

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

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

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

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- significant differences in the gross margins we achieve compared to expectations, based on changes in revenue levels, product mix and pricing, capacity utilization, variations in inventory valuation, excess or obsolete inventory, manufacturing yields, changes in unit costs, impairments of long-lived assets (including manufacturing, assembly/test and intangible assets), and the timing and execution of our manufacturing investment plans and associated costs, including start-up costs;

- the financial impact of obsolete or excess inventories if actual demand differs from our manufacturing plans;

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

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

- the outcome of litigation;

- the impact of intellectual property claims by our competitors or other third parties, and our ability to obtain required licenses on reasonable terms and conditions; and

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

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

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

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## PART I

### Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

### Item 2. Offer Statistics and Expected Timetable

Not applicable.

### Item 3. Key Information

**Selected Financial Data**

The table below sets forth our selected consolidated financial data for each of the years in the five-year period ended December 31, 2007. Such data have been derived from our Consolidated Financial Statements. Consolidated audited financial statements for each of the years in the three-year periods ended December 31, 2007, including the Notes thereto (collectively, the Consolidated Financial Statements ), are included elsewhere in this Form 20-F, while data for prior periods have been derived from our Consolidated Financial Statements used in such periods.

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

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| | (In millions except per share and ratio data) | | | | |
| **Consolidated Statements of Income Data:** | | | | | |
| Net sales | $ 9,966 | $ 9,838 | $ 8,876 | $ 8,756 | $ 7,234 |
| Other revenues | 35 | 16 | 6 | 4 | 4 |
| Net revenues | 10,001 | 9,854 | 8,882 | 8,760 | 7,238 |
| Cost of sales | (6,465) | (6,331) | (5,845) | (5,532) | (4,672) |
| Gross profit | 3,536 | 3,523 | 3,037 | 3,228 | 2,566 |
| Operating expenses: | | | | | |
| Selling, general and administrative | (1,099) | (1,067) | (1,026) | (947) | (785) |
| Research and development(1) | (1,802) | (1,667) | (1,630) | (1,532) | (1,238) |
| Other income and expenses, net(1) | 48 | (35) | (9) | 10 | (4) |
| Impairment, restructuring charges and other related closure costs | (1,228) | (77) | (128) | (76) | (205) |
| Total operating expenses | (4,081) | (2,846) | (2,793) | (2,545) | (2,232) |
| Operating income (loss) | (545) | 677 | 244 | 683 | 334 |
| | (46) | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Other-than-temporary impairment charge on financial assets | | | | | |
| Interest income (expense), net | 83 | 93 | 34 | (3) | (52) |
| Earnings (loss) on equity investments | 14 | (6) | (3) | (4) | (1) |
| Loss on extinguishment of convertible debt | | | | (4) | (39) |
| Income (loss) before income taxes and minority interests | (494) | 764 | 275 | 672 | 242 |
| Income tax benefit (expense) | 23 | 20 | (8) | (68) | 14 |
| Income (loss) before minority interests | (471) | 784 | 267 | 604 | 256 |
| Minority interests | (6) | (2) | (1) | (3) | (3) |
| Net income (loss) | $ (477) | $ 782 | $ 266 | $ 601 | $ 253 |
| Earnings (loss) per share (basic) | $ (0.53) | $ 0.87 | $ 0.30 | $ 0.67 | $ 0.29 |
| Earnings (loss) per share (diluted) | $ (0.53) | $ 0.83 | $ 0.29 | $ 0.65 | $ 0.27 |
| Number of shares used in calculating earnings per share (basic) | 898.7 | 896.1 | 892.8 | 891.2 | 888.2 |
| Number of shares used in calculating earnings per share (diluted) | 898.7 | 958.5 | 935.6 | 935.1 | 937.1 |

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| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| | (In millions except per share and ratio data) | | | | |
| **Consolidated Balance Sheet Data (end of period):** | | | | | |
| Cash and cash equivalents(2) | $ 1,855 | $ 1,659 | $ 2,027 | $ 1,950 | $ 2,998 |
| Marketable securities | 1,014 | 764 | | | |
| Short-term deposits | | 250 | | | |
| Restricted cash for equity investments | 250 | 218 | | | |
| Non-current marketable securities | 369 | | | | |
| Total assets | 14,272 | 14,198 | 12,439 | 13,800 | 13,477 |
| Short-term debt (including current portion of long-term debt) | 103 | 136 | 1,533 | 191 | 151 |
| Long-term debt (excluding current portion)(2) | 2,117 | 1,994 | 269 | 1,767 | 2,944 |
| Shareholders equity(2) | 9,573 | 9,747 | 8,480 | 9,110 | 8,100 |
| Capital stock(3) | 3,253 | 3,177 | 3,120 | 3,074 | 3,051 |
| **Other Data:** | | | | | |
| Dividends per share | $ 0.30 | $ 0.12 | $ 0.12 | $ 0.12 | $ 0.08 |
| Capital expenditures(4) | 1,140 | 1,533 | 1,441 | 2,050 | 1,221 |
| Net cash provided by operating activities | 2,188 | 2,491 | 1,798 | 2,342 | 1,920 |
| Depreciation and amortization(4) | 1,413 | 1,766 | 1,944 | 1,837 | 1,608 |
| Debt-to-equity ratio(5) | 0.23 | 0.22 | 0.21 | 0.21 | 0.38 |
| Net debt (cash) to total shareholders equity ratio(5) | (0.132) | (0.078) | (0.026) | 0.001 | 0.012 |

(1) Other income and expenses, net includes, among other things, funds received through government agencies for research and development expenses, the cost of new production facilities start-ups, foreign currency gains and losses, gains on sales of marketable securities and non-current assets and the costs of certain activities relating to intellectual property. Our reported research and development expenses are mainly in the areas of product design, technology and development, and do not include marketing design center costs, which are accounted for as selling expenses, or process engineering, pre-production and process-transfer costs, which are accounted for as cost of sales.

(2) On November 16, 2000, we issued $2,146 million initial aggregate principal amount of Zero-Coupon Senior Convertible Bonds due 2010 (the 2010 Bonds ), for net proceeds of $1,458 million; in 2003, we repurchased on the market approximately $1,674 million aggregate principal amount at maturity of 2010 Bonds. During 2004, we completed the repurchase of our 2010 Bonds and repurchased on the market approximately $472 million aggregate principal amount at maturity for a total amount paid of $375 million. In 2001, we redeemed the remaining $52 million of our outstanding Liquid Yield Option Notes due 2008 (our 2008 LYONs ) and converted them into common shares in May and June 2001. In 2001, we repurchased 9,400,000 common shares for $233 million, and in 2002, we repurchased an additional 4,000,000 shares for $115 million. We reflected these purchases at cost as a reduction of shareholders equity. The repurchased shares have been designated for allocation under our share-based compensation programs on non-vested shares, including the plans as approved by the 2005, 2006 and 2007 annual general shareholders meetings, and those which may be attributed in the future. As of December 31, 2007, 2,867,119 shares were transferred to employees upon vesting of stock awards. In August 2003, we issued $1,332 million principal amount at issuance of our convertible bonds due 2013 (our

2013 Convertible Bonds ) with a negative yield of 0.5% that resulted in a higher principal amount of $1,400 million and net proceeds of $1,386 million. During 2004, we repurchased all of our outstanding Liquid Yield Option Notes due 2009 (our 2009 LYONs ) for a total amount of cash paid of $813 million. In February 2006, we issued Zero Coupon Senior Convertible Bonds due 2016 (our 2016 Convertible Bonds ) representing total gross proceeds of $974 million. In March 2006, we issued 500 million Floating Rate Senior Bonds due 2013 (our 2013 Senior Bonds ). In August 2006, as a result of almost all of the holders of our 2013 Convertible Bonds exercising their August 4, 2006 put option, we repurchased $1,397 million aggregate principal amount of the outstanding convertible bonds at a conversion ratio of $985.09 per $1,000 aggregate principal amount at issuance resulting in a cash disbursement of $1,377 million.

(3) Capital stock consists of common stock and capital surplus.

(4) Capital expenditures are net of certain funds received through government agencies, the effect of which is to decrease depreciation.

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

**Risk Factors**

**Risks Related to the Semiconductor Industry**

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

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

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

***Reduction in demand or increase in production capacity for semiconductor products may lead to overcapacity, which in turn may require plant closures, asset impairments, restructuring charges and inventory write-offs.***

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

According to data published by industry sources, investments in worldwide semiconductor fabrication capacity totaled approximately $29.5 billion in 2003, $45.7 billion in 2004, $46.1 billion in 2005, $54.8 billion in 2006 and an estimated $57.2 billion in 2007, or approximately 18%, 22%, 20%, 22% and 22%, respectively, of the total available market (the TAM ) for these years. The net increase of manufacturing capacity, defined as the difference between capacity additions and capacity reductions, may exceed demand requirements, leading to overcapacity and price erosion.

In recent years, overcapacity and cost optimization have led us to close manufacturing facilities that used more mature process technologies and, as a result, to incur significant impairment, restructuring charges and related closure costs.

In 2007 we announced closures of our Phoenix, Carrollton, and Ain Sebaa manufacturing facilities and recorded impairment, restructuring charges and related closure costs of $73 million. Previously announced restructuring and cost reduction plans were substantially completed as of December 31, 2007 and resulted in total charges of approximately $38 million. See Item 5. Operating and Financial Review and Prospects Impairment, Restructuring Charges and Other Related Closure Costs.

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

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

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

price;

technical performance;

product features;

product system compatibility;

product design and technology;

timely introduction of new products;

product availability;

manufacturing yields; and

sales and technical support.

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

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

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

Even after obtaining a product design win from one of our customers, we may still experience delays in generating revenue from our products as a result of our customers or our lengthy development and design cycle. In addition, a delay or cancellation of a customer s plans could significantly adversely affect our financial results, as we may have incurred significant expense and generated no revenue at the time of such delay or cancellation. Finally, if our

customers fail to successfully market and sell their own products, it could materially adversely affect our business, financial condition and results of operations as the demand for our products falls.

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

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

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

We also regularly incur costs to acquire technology from third parties without any guarantee of realizing the anticipated value of such expenditures due to better market acceptance of technologies developed by competitors or market demand. We charged $47 million as annual amortization expense on our consolidated statement of income in 2007 related to technologies and licenses acquired from third parties. In 2007 we signed a major technology

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development agreement with IBM to develop 32-nm and 22-nm complementary metal-oxide-semiconductor ( CMOS ) process technology for 300-mm silicon wafers in order to pursue ongoing core CMOS technology development following the termination of the R&D Crolles 2 Alliance with Freescale Semiconductor and NXP Semiconductors starting this year. We also signed an agreement with IBM to license a derivative technology to implement in our proprietary process for the manufacture of 45-nm integrated circuits. As of December 31, 2007, the residual value, net of amortization, registered in our consolidated balance sheet for these technologies and licenses was $128 million. In addition to amortization expenses, the value of these assets may be subject to impairment with associated charges being made to our Consolidated Financial Statements.

In November 2007 we closed a business acquisition, which included intellectual property and design engineers, in the wireless market for approximately $92 million. In December 2007 we announced, and in January 2008 completed the acquisition of Genesis Microchip Inc. ( Genesis Microchip ) for intellectual property related to the digital consumer marketplace and design engineers for $342 million. There is no assurance that such purchases will be successful and will not lead to impairments and associated charges.

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

We are continuously considering various measures to improve our competitive position and cost structure in the semiconductor industry.

In 2007 we also made the decision to divest our Flash Memory activities by combining our business with that of Intel and announcing the planned creation of a new independent semiconductor company in the area of Flash memories, which was named Numonyx. The intent is that such new company will benefit from critical size to be competitive in this market. The transaction concerning the creation of Numonyx is planned to close in the first quarter of 2008. There is no assurance that such transaction will close within the timeframe and pursuant to the terms currently planned.

Recently, our sales increased at a slower pace than the semiconductor industry as a whole and our market share declined, even in relation to the markets we serve. Although we recovered in 2006 with an increase in our sales of 11% compared to an increase of 9% for the industry overall, in 2007, our sales increased 1.5% while the industry increased by approximately 3%. There is no assurance that we will be able to maintain or to grow our market share, if we are not able to accelerate product innovation, extend our customer base, realize manufacturing improvements and/or otherwise control our costs. In addition, in recent years the semiconductor industry has continued to increase manufacturing capacity in Asia in order to access lower-cost production and to benefit from higher overall efficiency, which has led to a stronger competitive environment. We may also in the future, if market conditions so require, consider additional measures to improve our cost structure and competitiveness in the semiconductor market, such as increasing our production capacity in Asia, discontinuing certain product families or adding restructurings, which in turn may result in loss of revenues, asset impairments and/or capital losses.

**Risks Related to Our Operations**

***Strategic repositioning may be required, in light of market dynamics, to improve our business performance.***

As a result of a strategic review of our product portfolio, we decided in 2007 to divest our Flash Memory activities by combining our business with that of Intel and announcing the planned creation of a new independent semiconductor company in the area of Flash memories, which was named Numonyx. The intent is that such new company will benefit from critical size to be competitive in this market. The transaction concerning the creation of Numonyx is planned to close in the first quarter of 2008. In 2007 we incurred a loss of $1,106 million in connection with this

planned transaction. The amount of the loss may increase pending the final evaluation report being prepared by an independent firm, as well as the impact of any further deterioration in the market conditions of the Flash memory business and the credit markets generally. Further, if the transaction is postponed or not consummated as planned, we may incur additional charges. Once Numonyx begins operations, we may also incur losses proportionate to our equity holding in this company.

Additionally, we are constantly monitoring our product portfolio and cannot exclude that additional steps in this repositioning process may be required; further, we cannot assure that the strategic repositioning of our business will be successful and produce the planned operational and strategic benefits and may not result in further impairment and associated charges.

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***Future acquisitions or divestitures may adversely affect our business.***

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

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

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

- diversion of management s attention;
- difficult integration of acquired company operations and personnel;
- loss of activities and technologies that may have complemented our remaining businesses;
- insufficient intellectual property rights or potential inaccuracies in the ownership of key IP;
- assumption of potential liabilities, disclosed or undisclosed, associated with the business acquired, which liabilities may exceed the amount of indemnification available from the seller;
- potential inaccuracies in the financial and accounting systems utilized by the business acquired;
- that the businesses acquired will not maintain the quality of products and services that we have historically provided;
- whether we are able to attract and retain qualified management for the acquired business;
- loss of important services provided by key employees that are assigned to divested activities;
- whether we are able to retain customers of the acquired entity; and
- goodwill and other intangible asset impairment, due to the inability of the business to meet management s expectations at the time of the acquisition.

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

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

In less favorable industry environments, we are driven to reduce prices in response to competitive pressures and we are also faced with a decline in the utilization rates of our manufacturing facilities due to decreases in product demand. Reduced average selling prices for our products adversely affect our results of operations. Since the semiconductor industry is characterized by high fixed costs, we are not always able to reduce our total costs in line with revenue declines. Furthermore, in periods of reduced customer demand for our products, our wafer fabrication plants ( fabs ) do not operate at full capacity and the costs associated with the excess capacity are charged directly to cost of sales as

unused capacity charges. Additionally, a significant number of our manufacturing facilities are located in France and Italy and their cost of operation have been significantly affected by the rise of the Euro against the U.S. dollar, our reporting currency, over the last few years. In 2007 the U.S. dollar was $1.35 to 1.00 compared to $1.24 in 2006 and may weaken further in the future. Over the last five years, our gross profit margin has varied from a high of 37.9% in the third quarter of 2004 to a low of 32.9% in the first quarter of 2005. We cannot guarantee that difficult market conditions will not adversely affect the capacity utilization of our fabs and, consequently our future gross margins. We cannot guarantee that increased competition in our core product markets will not lead to further price erosion, lower revenue growth rates and lower margins.

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

The intensely competitive environment of the semiconductor industry and the high costs associated with developing marketable products and manufacturing technologies may lead to further consolidation in the industry. Such consolidation can allow a company to further benefit from economies of scale, provide improved or more

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diverse product portfolios and increase the size of its serviceable market. Consequently, we may seek to acquire a competitor to improve our market position and the applications and products we can market. We may also become a target for a company looking to improve its competitive position. Such an occurrence may take place at any time with consequences that may not be predictable and which can have a materially adverse effect on our results of operations and financial condition.

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

A significant variation of the value of the U.S. dollar against the principal currencies which have a material impact on us (primarily the Euro, but also certain other currencies of countries where we have operations) could result in a favorable impact on our net income in the case of an appreciation of the U.S. dollar, or a negative impact on our net income if the U.S. dollar depreciates relative to these currencies. Currency exchange rate fluctuations affect our results of operations because our reporting currency is the U.S. dollar, in which we receive the major part of our revenues, while, more importantly, we incur a significant portion of our costs in currencies other than the U.S. dollar. Certain significant costs incurred by us, such as manufacturing labor costs and depreciation charges, selling, general and administrative expenses, and research and development expenses, are incurred in the currencies of the jurisdictions in which our operations are located. Our effective average exchange rate, which reflects actual exchange rate levels combined with the impact of hedging programs, was $1.35 to  1.00 in 2007, compared to $1.24 in 2006.

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

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

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

As a result of our choice to maintain control of a certain portion of our advanced proprietary manufacturing technologies to better serve our customer base and to develop our strategic alliances, significant amounts of capital to maintain or upgrade our facilities could be required in the future. Our capital expenditures have been significant in recent years and we spent $1.1 billion in 2007. See  Item 5. Operating and Financial Review and Prospects  Liquidity and Capital Resources.  We have evolved our strategy towards a less capital intensive model and as such we expect our capital expenditures to be in the range of 10% of our 2008 revenues. Our costs may also increase as the complexity of the individual manufacturing equipment increases. We have the flexibility to modulate our investments up or down in response to changes in market conditions, and we are prepared to accelerate investments in leading-edge technologies

if market conditions require.

To stay competitive in the semiconductor industry, we must transition towards 300-mm manufacturing technology, which is much more expensive than 150-mm or 200-mm technologies. We operated a 300-mm facility with Freescale Semiconductor, Inc. (formerly a division of Motorola Inc.) ( Freescale Semiconductor ) and NXP Semiconductors B.V. (formerly Philips Semiconductor International B.V.) ( NXP Semiconductors ) until December 31, 2007 in Crolles, France ( Crolles2 ). This relationship has since expired and we have chosen to take full ownership of the fab and acquire our former partners equipment. This choice may lead to an increase in our manufacturing costs. Following the announced closures in 2007 of our 200-mm facility in Phoenix and our

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150-mm facility in Carrollton, we are in the process of transferring production primarily to other facilities, which involves certain risks as customers are required to requalify these facilities.

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

In an increasingly complex and competitive environment, we may need to invest in other companies and/or in technology developed by third parties to improve our position in the market. We may also consider acquisitions to complement or expand our existing business. Any of the foregoing may also require us to issue additional debt, equity, or both; the timing and the size of any new share or bond offering would depend upon market conditions as well as a variety of factors, and any such transaction or any announcement concerning such a transaction could materially impact the market price of our common shares. If we are unable to access such capital on acceptable terms, this may adversely affect our business and results of operations.

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

We are dependent on alliances to develop or access new technologies, due to the increasing levels of required investments, and there can be no assurance that these alliances will be successful. For example, we had been cooperating with Freescale Semiconductor and NXP Semiconductors for the joint research and development of CMOS process technology to provide 90-nm to 45-nm chip technologies on 300-mm wafers, as well as the operation of a 300-mm wafer pilot line fab in Crolles, France. We had first formed the Crolles2 alliance with NXP Semiconductors in 2000 and renewed the partnership in 2002 when Freescale Semiconductor joined the alliance ( Crolles2 Alliance ). The Crolles2 Alliance was strengthened in 2002 through a joint development program with TSMC for process technology alignment, in 2004 by the Nanotec-300 research program with CEA-LETI for the development of the 45-nm and 32-nm process technology nodes, and again in 2005 by including 300-mm wafer testing and packaging, as well as the development and licensing of core libraries and intellectual property ( IP ). The Crolles2 Alliance expired on December 31, 2007, as a result of the decision of both NXP Semiconductors and Freescale Semiconductors to terminate their participation at the end of the initial term.

We signed an agreement with IBM effective January 1, 2008 to collaborate on the development of advanced CMOS process technology that is used in semiconductor development and manufacturing. The agreement includes 32-nm and 22-nm CMOS process-technology development, design enablement and advanced research adapted to the manufacturing of 300-mm silicon wafers. In addition, it includes both the core bulk CMOS technology and value-added derivative System-on-Chip ( SoC ) technologies. The new agreement between IBM and us will also include collaboration on IP development and platforms to speed the design of SoC devices in these technologies. We also signed an agreement with IBM to license a derivative technology to implement in our proprietary process for the manufacture of 45nm integrated circuits.

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

industry may decrease and we may also lose market share in the market addressed by our products.

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

Our operating results are affected by a wide variety of factors that could materially and adversely affect revenues and profitability or lead to significant variability of operating results. These factors include, among others, the cyclicality of the semiconductor and electronic systems industries, capital requirements, inventory management, availability of funding, competition, new product developments, technological changes and manufacturing problems. Furthermore, our effective tax rate currently takes into consideration certain favorable tax rates and

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incentives, which, in the future, may not be available to us. See Note 23 to our Consolidated Financial Statements. In addition, a number of other factors could lead to fluctuations in quarterly and annual operating results, including:

- performance of our key customers in the markets they serve;
- order cancellations or reschedulings by customers;
- excess inventory held by customers leading to reduced bookings or product returns by key customers;
- manufacturing capacity and utilization rates;
- restructuring and impairment charges;
- fluctuations in currency exchange rates, particularly between the U.S. dollar and other currencies in jurisdictions where we have activities;
- intellectual property developments;
- changes in distribution and sales arrangements;
- failure to win new design projects;
- manufacturing performance and yields;
- product liability or warranty claims;
- litigation;
- acquisitions or divestitures;
- problems in obtaining adequate raw materials or production equipment on a timely basis;
- property damage or business interruption losses resulting from a catastrophic event not covered by insurance; and
- changes in the market value or yield of the financial instruments in which we invest our liquidity.

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

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

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

- spending levels of telecommunications equipment, industrial and/or automotive providers;
- development of new consumer products or applications requiring high semiconductor content;
- evolving industry standards;
- the rate of adoption of new or alternative technologies; and
- demand for automobiles, consumer confidence and general economic conditions.

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

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

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

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

A substantial portion of our sales is derived from several large customers, some of whom have entered into strategic alliances with us. As of December 31, 2007, our largest customer was Nokia, which accounted for 21.1% of our 2007 net revenues, compared to 21.8% in 2006 and 22.4% in 2005. In 2007, our top ten original equipment manufacturers ( OEM ) customers accounted for approximately 49% of our net revenues, compared to approximately 51% of our 2006 net revenues and approximately 50% of our 2005 net revenues. We cannot guarantee that our largest customers will continue to book the same level of sales with us that they have in the past and will not solicit alternative suppliers. Many of our key customers operate in cyclical businesses that are also highly competitive, and their own demands and market positions may vary considerably. In recent years, certain customers of the semiconductor industry have experienced consolidation. Such consolidations may impact our business in the sense that our relationships with the new entities could be either reinforced or jeopardized pursuant thereto. Our customers have in the past, and may in the future, vary order levels significantly from period to period, request postponements to scheduled delivery dates or modify their bookings. Approximately 20% of our net revenues were made through distributors in 2007, compared to approximately 19% in 2006 and approximately 18% in 2005. We cannot guarantee that we will be able to maintain or enhance our market share with our key customers or distributors. If we were to lose one or more design wins for our products with our key customers, or if any key customer or distributors were to reduce or change its bookings, seek alternate suppliers, increase its product returns or fail to meet its payment obligations, our business financial condition and results of operations could be materially adversely affected. If customers do not purchase products made specifically for them, we may not be able to resell such products to other customers or require the customers who have ordered these products to pay a cancellation fee. Furthermore, developing industry trends, including customers use of outsourcing and new and revised supply chain models, may reduce our ability to forecast the purchase date for our products and evolving customer demand, thereby affecting our revenues and working capital requirements. For example, pursuant to industry developments, some of our products are required to be delivered on consignment to customer sites with recognition of revenue delayed until such moment, which must occur within a defined period of time, when the customer chooses to take delivery of our products from our consignment stock.

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

Our operating results can also vary significantly due to impairment of goodwill booked pursuant to acquisitions and to the purchase of technologies and licenses from third parties. As of December 31, 2007, the value registered on our audited consolidated balance sheet for goodwill was $290 million and the value for technologies and licenses acquired from third parties was $128 million, net of amortization. Because the market for our products is characterized by rapidly changing technologies, and because of significant changes in the semiconductor industry, our future cash flows may not support the value of goodwill and other intangibles registered in our consolidated balance sheet. Furthermore, the ability to generate revenues for our fixed assets located in Europe may be impaired by an increase in the value of the Euro with respect to the U.S. dollar, as the revenues from the use of such assets are generated in U.S. dollars. We are required to annually test goodwill and to assess the carrying values of intangible and tangible

assets when impairment indicators exist. As a result of such tests, we could be required to book impairment in our statement of income if the carrying value in our consolidated balance sheet is in excess of the fair value. The amount of any potential impairment is not predictable as it depends on our estimates of projected market trends, results of operations and cash flows. In addition, the introduction of new accounting standards can lead to a different assessment of goodwill carrying value, which could lead to a potential impairment of the goodwill amount. Any potential impairment, if required, could have a material adverse impact on our results of operations.

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

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

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

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

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

***We may be faced with product liability or warranty claims.***

Despite our corporate quality programs and commitment, our products may not in each case comply with specifications or customer requirements. Although our practice, in line with industry standards, is to contractually limit our liability to the repair, replacement or refund of defective products, warranty or product liability claims could result in significant expenses relating to compensation payments or other indemnification to maintain good customer relationships if a customer threatens to terminate or suspend our relationship pursuant to a defective product supplied by us. Furthermore, we could incur significant costs and liabilities if litigation occurs to defend against such claims and if damages are awarded against us. In addition, it is possible for one of our customers to

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recall a product containing one of our parts. Costs or payments we may make in connection with warranty claims or product recalls may adversely affect our results of operations. There is no guarantee that our insurance policies will be available or adequate to protect against such claims.

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

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

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

We depend on our ability to obtain patents and other intellectual property rights covering our products and their design and manufacturing processes. We intend to continue to seek patents on our inventions relating to product designs and manufacturing processes. However, the process of seeking patent protection can be long and expensive, and we cannot guarantee that we will receive patents from currently pending or future applications. Even if patents are issued, they may not be of sufficient scope or strength to provide meaningful protection or any commercial advantage. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in some countries. Competitors may also develop technologies that are protected by patents and other intellectual property and therefore either be unavailable to us or be made available to us subject to adverse terms and conditions. We have in the past used our patent portfolio to negotiate broad patent cross-licenses with many of our competitors enabling us to design, manufacture and sell semiconductor products, without fear of infringing patents held by such competitors. We may not, however, in the future be able to obtain such licenses or other rights to protect necessary intellectual property on favorable terms for the conduct of our business, and such failure may adversely impact our results of operations.

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

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

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

We are subject to a variety of laws and regulations relating, among other things, to the use, storage, discharge and disposal of chemicals, gases and other hazardous substances used in our manufacturing processes, air emissions, waste water discharges, waste disposal, as well as the investigation and remediation of soil and ground water contamination. European Directive 2002/96/EC ( WEEE Directive) imposes a take back obligation on manufacturers for the financing of the collection, recovery and disposal of electrical and electronic equipment. Additionally, European Directive 2002/95/EC ( ROHS Directive) banned the use of lead and some flame retardants in electronic components as of July 2006. Our activities in the EU are also subject to the European Directive 2003/87/EC establishing a scheme for greenhouse gas allowance trading, and to the applicable national implementing legislation. In addition, Regulation 1907/2006 of December 18, 2006 requires the registration,

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evaluation, authorization and restriction of a large number of chemicals ( REACH ). The REACH process started on June 1, 2007. The implementation of any such legislation could adversely affect our manufacturing costs or product sales by requiring us to acquire costly equipment, materials or greenhouse gas allowances, or to incur other significant expenses in adapting our manufacturing processes or waste and emission disposal processes. We are not in a position to quantify specific costs, in part because these costs are part of our business process. Furthermore, environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us, suspension of production or a cessation of operations. As with other companies engaged in similar activities, any failure by us to control the use of, or adequately restrict the discharge of, chemicals or hazardous substances could subject us to future liabilities. Any specific liabilities we identify as probable would be reflected in our consolidated balance sheet. To date, we have not identified any such specific liabilities. We therefore have not booked specific reserves for any specific environmental risks. See Item 4. Information on the Company Environmental Matters.

***Loss of key employees could hurt our competitive position.***

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

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

We operate in many jurisdictions with highly complex and varied tax regimes. Changes in tax rules or the outcome of tax assessments and audits could have a material adverse effect on our results in any particular quarter. For example, in 2007, we had a tax benefit of $23 million, as compared to a tax benefit of $20 million in 2006. In 2007, it included $72 million of benefit related to the impairment on assets to be contributed into the planned disposal of the Flash Memories Group s ( FMG ) assets held for sale. In 2006, we benefited from a favorable assessment of our tax assets and liabilities mainly due to a favorable outcome of a tax litigation in one of the jurisdictions in which we operate. Our tax rate is variable and depends on changes in the level of operating profits within various local jurisdictions and on changes in the applicable taxation rates of these jurisdictions, as well as changes in estimated tax provisions due to new events. We currently receive certain tax benefits in some countries, and these benefits may not be available in the future due to changes in the local jurisdictions. As a result, our effective tax rate could increase in the coming years.

In line with our strategic repositioning of our product portfolio, the purchase or divestiture of businesses in different jurisdictions could materially affect our effective tax rate in future periods.

We are subject to the possibility of loss contingencies arising out of tax claims, assessment of uncertain tax positions and provisions for specifically identified income tax exposures. There can be no assurance that we will be successful in resolving such tax claims. Our failure to do so and/or the need to increase our provisions for such claims could have a material adverse effect on our financial position.

***We are required to prepare Consolidated Financial Statements using both International Financial Reporting Standards ( IFRS ) in addition to our Consolidated Financial Statements prepared pursuant to Generally Accepted Accounting Principles in the United States ( U.S. GAAP ) and dual reporting may impair the clarity of our financial reporting.***

We are incorporated in the Netherlands and our shares are listed on Euronext Paris and on the Borsa Italiana, and, consequently, we are subject to an EU regulation issued on September 29, 2003 requiring us to report our results of operations and Consolidated Financial Statements using IFRS (previously known as International Accounting Standards or IAS ). As from January 1, 2008 we are also required to prepare a semi-annual set of accounts using IFRS reporting standards. We use U.S. GAAP as our primary set of reporting standards, as U.S. GAAP has been our reporting standard since our creation in 1987. Applying U.S. GAAP in our financial reporting is designed to ensure the comparability of our results to those of our competitors, as well as the continuity of our reporting, thereby providing our investors with a clear understanding of our financial performance.

The obligation to report our Consolidated Financial Statements under IFRS requires us to prepare our results of operations using two different sets of reporting standards, U.S. GAAP and IFRS, which are currently not consistent. Such dual reporting materially increases the complexity of our investor communications. The main potential areas of discrepancy concern capitalization and amortization of development expenses required under IFRS and the

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accounting for compound financial instruments. Our financial condition and results of operations reported in accordance with IFRS will differ from our financial condition and results of operations reported in accordance with U.S. GAAP, which could adversely affect the market price of our common shares.

Our reporting under two different accounting standards filed with the relevant regulatory authorities, also now in interim periods, could result in confusion if recipients of the information do not properly distinguish between the information reported using U.S. GAAP and the information reported using IFRS, particularly when viewing our profitability and operating margins under one or the other set of accounting standards. Given this risk, and the complexity of maintaining and reviewing two sets of accounts, we may consider at some point in the future to report primarily in IFRS.

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

The SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules that require us to include a management report assessing the effectiveness of our internal control over financial reporting in our annual report on Form 20-F. In addition, we must also include an attestation by our independent registered public accounting firm regarding the effectiveness of our internal control over financial reporting. We have successfully completed our Section 404 assessment and received the auditors attestation as of December 31, 2007. However, in the future, if we fail to complete a favorable assessment from our management or to obtain our auditors attestation, we may be subject to regulatory sanctions or may suffer a loss of investor confidence in the reliability of our financial statements, which could lead to an adverse effect on our stock price.

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

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

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

The application for and implementation of such grants often involves compliance with extensive regulatory requirements including, in the case of subsidies to be granted within the EU, notification to the European Commission by the member state making the contemplated grant prior to disbursement and receipt of required EU approval. In addition, compliance with project-related ceilings on aggregate subsidies defined under EU law often involves highly complex economic evaluations. Furthermore, public funding arrangements are generally subject to annual and

project-by-project reviews and approvals. If we fail to meet applicable formal or other requirements, we may not be able to receive the relevant subsidies, which could have a material adverse effect on our results of operations. If we do not receive anticipated fundings, this may lead us to curtail or discontinue existing projects, which may lead to further impairments. In addition, if we do not complete projects for which public funding has been approved we may be required to repay any advances received for completed milestones, which may lead to a material adverse effect on our results of operations.

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

We have been informed that as of December 31, 2007, STMicroelectronics Holding II B.V. ( ST Holding II ), a wholly-owned subsidiary of STMicroelectronics Holding N.V. ( ST Holding ), owned 250,704,754 shares, or approximately 27.5%, of our issued common shares. ST Holding is therefore effectively in a position to control

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actions that require shareholder approval, including corporate actions, the election of our Supervisory Board and our Managing Board and the issuance of new shares or other securities.

We have also been informed that the shareholders agreement among ST Holding s shareholders (the STH Shareholders Agreement ), to which we are not a party, governs relations between our current indirect shareholders Areva Group, Cassa Depositi e Prestiti S.p.A. ( CDP ) and Finmeccanica S.p.A. ( Finmeccanica ), each of which is ultimately controlled by the French or Italian government, see Item 7. Major Shareholders and Related-Party Transactions Major Shareholders. The STH Shareholders Agreement includes provisions requiring the unanimous approval by shareholders of ST Holding before ST Holding can make any decision with respect to certain actions to be taken by us. Furthermore, as permitted by our Articles of Association, the Supervisory Board has specified selected actions by the Managing Board that require the approval of the Supervisory Board. See Item 7. Major Shareholders and Related-Party Transactions Major Shareholders. These requirements for the prior approval of various actions to be taken by us and our subsidiaries may give rise to a conflict of interest between our interests and investors interests, on the one hand, and the interests of the individual shareholders approving such actions, on the other, and may affect the ability of our Managing Board to respond as may be necessary in the rapidly changing environment of the semiconductor industry. Our ability to issue new shares or other securities may be limited by the existing shareholders desire to maintain their proportionate shareholding at a certain minimum level and our ability to buy back shares may be limited by a recently enacted Dutch law that may require shareholders that own more than 30% of our voting rights to launch a tender offer for our outstanding shares. Dutch law, however, requires members of our Supervisory Board to act independently in supervising our management and to comply with applicable Dutch and non-Dutch corporate governance standards.

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

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

No preference shares have been issued to date. The effect of the preference shares may be to deter potential acquirers from effecting an unsolicited acquisition resulting in a change of control or otherwise taking actions considered hostile by our Managing Board and Supervisory Board. In addition, any issuance of additional capital within the limits of our authorized share capital, as approved by our shareholders, is subject to the requirements of our Articles of Association, see Item 10. Additional Information Memorandum and Articles of Association Share Capital as of December 31, 2007 Issuance of Shares, Preemption Rights and Preference Shares (Article 4).

***Our direct or indirect shareholders may sell our existing common shares or issue financial instruments exchangeable into our common shares at any time. In addition, substantial sales by us of new common shares or convertible bonds could cause our common share price to drop significantly.***

The STH Shareholders Agreement, to which we are not a party, between respectively FT1CI our French Shareholder controlled by Areva, and Cassa Depositi e Prestiti and Finmeccanica, our Italian shareholder, permits our respective French and Italian indirect shareholders to cause ST Holding to dispose of its stake in us at its sole discretion at any time from their current level, and to reduce the current level of their respective indirect interests in our common shares. We have recently been informed that FT1CI, Areva, Cassa Depositi e Prestiti have agreed to modify the STH Shareholders Agreement. The details of the STH Shareholders Agreement as declared by ST Holding II are further explained in Item 7. Major Shareholders and Related-Party Transactions Major Shareholders. Disposals of our shares by the parties to the STH Shareholders Agreement can be made by

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way of the issuance of financial instruments exchangeable for our shares, equity swaps, structured finance transactions or sales of our shares. An announcement with respect to one or more of such dispositions could be made at any time without our advance knowledge.

In addition, Finmeccanica Finance S.A. ( Finmeccanica Finance ), a subsidiary of Finmeccanica, has issued 501 million aggregate principal amount of exchangeable notes, exchangeable into up to 20 million of our existing common shares due 2010 (the Finmeccanica Notes ). The Finmeccanica Notes have been exchangeable at the option of the holder into our existing common shares since January 2, 2004. In September 2005, France Telecom caused the sale of approximately 26 million of our common shares pursuant to the terms of a convertible bond issued by France Telecom. In December 2005, Finmeccanica caused the sale of approximately 1.5 million of our common shares. On February 27, 2008 Finmeccanica announced that it would sell approximately 26 million of our shares representing approximately 2,85% of our share capital to FT1CI.

Further sales of our common shares or issue of bonds exchangeable into our common shares or any announcements concerning a potential sale by ST Holding, FT1CI, Areva, CDP or Finmeccanica, could materially impact the market price of our common shares. The timing and size of any future share or exchangeable bond offering by ST Holding, FT1CI, Areva, CDP or Finmeccanica would depend upon market conditions as well as a variety of factors.

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

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

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

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

grounds that are internationally acceptable and that proper legal procedures have been observed, the court in the Netherlands would, under current practice, give binding effect to the final judgment that has been rendered in the United States unless such judgment contravenes the Netherlands public policy.

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

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

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## Item 4. Information on the Company

### History and Development of the Company

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

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

### Business Overview

We are a global independent semiconductor company that designs, develops, manufactures and markets a broad range of semiconductor products used in a wide variety of microelectronic applications, including automotive products, computer peripherals, telecommunications systems, consumer products, industrial automation and control systems. According to provisional industry data published by iSuppli, we have been ranked the world s fifth largest semiconductor company based on forecasted 2007 total market sales and we held leading positions in sales of Analog Products and Application Specific Integrated Circuits (or ASICs ). Based on provisional 2007 results published by iSuppli, we believe we were number one in industrial products, number two in analog products, number three in wireless and automotive electronics, and number four in NOR Flash. Based on most recent industry results, we also believe we ranked as a leading supplier of semiconductors in 2007 for set-top boxes, power management devices and for the inkjet printer market. Our top 20 customers include Alcatel-Lucent, Bosch, Cisco, Conti, Delphi, Delta, Denso, Ericsson, Hewlett-Packard, LG Electronics, Marelli, Motorola, Nintendo, Nokia, Philips, Pioneer, Samsung, Seagate, Sharp, Siemens, Thomson and Western Digital. We also sell our products through global distributors and retailers, including Arrow Electronics, Avnet, BSI Semiconductor, Future Electronics, Wintech and Yosun.

The semiconductor industry has historically been a cyclical one and we have responded through emphasizing balance in our product portfolio, in the applications we serve, and in the regional markets we address. Consequently, from 1994 through 2007, our revenues grew at a compounded annual growth rate of 10.8% compared to 7.3% for the industry as a whole.

We offer a broad and diversified product portfolio and develop products for a wide range of market applications to reduce our dependence on any single product, application or end market. Within our diversified portfolio, we have focused on developing products that leverage our technological strengths in creating customized, system-level solutions with high-growth digital and mixed-signal content. Our product families include differentiated application-specific products (which we define as being our dedicated analog, mixed-signal and digital ASIC and Application Specific Standard Products ( ASSP ) offerings and semicustom devices) that we organized under our Application Specific Product Groups ( ASG ); power devices, microcontrollers, discrete products, special nonvolatile

memory and Smartcard products organized under our Industrial and Multisegment Sector ( IMS ) and Flash Memories Group ( FMG ). Our ASG products, which are generally less vulnerable to market cycles than standard commodity products, accounted for 54.4% of our net revenues in 2007. Our IMS product accounted for 31.4% of our net revenues in 2007, while sales of our FMG products accounted for 13.6% of our net revenues in 2007.

Our products are manufactured and designed using a broad range of manufacturing processes and proprietary design methods. We use all of the prevalent function-oriented process technologies, including CMOS, bipolar and nonvolatile memory technologies. In addition, by combining basic processes, we have developed advanced systems-oriented technologies that enable us to produce differentiated and application-specific products, including bipolar CMOS technologies ( BiCMOS ) for mixed-signal applications, and diffused metal oxide semiconductor ( DMOS ) technology and Bipolar, CMOS and DMOS ( BCD technologies ) for intelligent power applications

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

Effective January 1, 2007, to meet the evolving requirements of the market together with the pursuit of a strategic repositioning in Flash memory, we reorganized our product segment groups into ASG, IMS and FMG. Since this date, we report our sales and operating income in three segments:

ASG is comprised of the Mobile, Multimedia & Communications Group ( MMC ), the Home Entertainment & Displays Group ( HED ), the Automotive Product Group ( APG ) and the Computer Peripherals Group ( CPG );

IMS is comprised of the Analog, Micro-Electronic-Mechanical Systems ( MEMS ), and Power Group ( AMP ) and the Microcontrollers, Memories and Smartcards Group ( MMS ); and

the FMG incorporates all of the Flash memory operations (both NOR and NAND), including technology R&D, all product related activities, front-end and back-end manufacturing, marketing and sales worldwide.

Our principal investment and resource allocation decisions in the semiconductor business area are for expenditures on technology research and development as well as capital investments in front-end and back-end manufacturing facilities, which are planned at the corporate level; therefore, our product segments share common research and development for process technology and manufacturing capacity for most of their products. However, in view of the contemplated FMG business disposal, FMG has incorporated since January 1, 2007 all of the Flash memory operations (both NOR and NAND), including technology R&D, all product related activities, front-end and back-end manufacturing, marketing and sales worldwide.

In the past three years, we have pursued various initiatives to reshape our company by (i) establishing a less capital-intensive business model; (ii) repositioning our product portfolio in order to improve financial returns; (iii) improving our manufacturing competitiveness through the restructuring of our production capacity with a view to increased overall efficiencies; (iv) improving our research and development effectiveness through a program focusing on our key products and redeployment of certain resources with the aim to improve time-to-market; (v) promoting sales expansion for mass market applications and new major key accounts with a special focus on the Chinese and Japanese markets; and (vi) changing and reorganizing our management team.

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**Results of Operations**

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | (In millions, except percentages) | | |
| **Net Revenues by Product Segment** | | | |
| Application Specific Groups (ASG) | $ 5,439 | $ 5,395 | $ 4,991 |
| Industrial and Multisegment Sector (IMS) | 3,138 | 2,842 | 2,482 |
| Flash Memories Group (FMG) | 1,364 | 1,570 | 1,351 |
| Others(1) | 60 | 47 | 58 |
| Total | $ 10,001 | $ 9,854 | $ 8,882 |
| **Net Revenues by Location of Order Shipment(2)** | | | |
| Europe | $ 3,159 | $ 3,073 | $ 2,789 |
| North America(3) | 1,176 | 1,232 | 1,281 |
| Asia Pacific(4) | 1,874 | 2,084 | 1,860 |
| Greater China(4) | 2,750 | 2,552 | 2,203 |
| Japan | 475 | 400 | 307 |
| Emerging Markets(3)(5) | 567 | 513 | 442 |
| Total | $ 10,001 | $ 9,854 | $ 8,882 |
| **Percentage of Net Revenues by Product Segment** | | | |
| Application Specific Groups (ASG) | 54.4% | 54.8% | 56.2% |
| Industrial and Multisegment Sector (IMS) | 31.4 | 28.8 | 27.9 |
| Flash Memories Group (FMG) | 13.6 | 15.9 | 15.2 |
| Others(1) | 0.6 | 0.5 | 0.7 |
| Total | 100% | 100.0% | 100.0% |
| **Percentage of Net Revenues by Location of Order Shipment(2)** | | | |
| Europe | 31.6% | 31.2% | 31.4% |
| North America(3) | 11.8 | 12.5 | 14.4 |
| Asia Pacific(4) | 18.7 | 21.1 | 20.9 |
| Greater China(4) | 27.5 | 25.9 | 24.8 |
| Japan | 4.7 | 4.1 | 3.5 |
| Emerging Markets(3)(5) | 5.7 | 5.2 | 5.0 |
| **Total** | 100.0% | 100.0% | 100.0% |

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

(2) Net revenues by location of order shipment are classified by location of customer invoiced. For example, products ordered by U.S.-based companies to be invoiced to Asia Pacific affiliates are classified as Asia Pacific revenues.

(3) As of July 2, 2006, the region North America includes Mexico which was part of Emerging Markets in prior periods. Amounts have been reclassified to reflect this change.

(4) As of January 1, 2006, we created a new region, Greater China to focus exclusively on our operations in China, Hong Kong and Taiwan. Net revenues for Asia Pacific for prior periods were restated according to the new perimeter.

(5) Emerging Markets includes markets such as India, Latin America (excluding Mexico), the Middle East and Africa, Europe (non-EU excluding Bulgaria and Romania and non-EFTA) and Russia.

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**Strategy**

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

- the changing long-term structural growth of the overall market for semiconductor products, which has moved from double-digit average growth rate to single-digit average growth rate over the last several years;
- the strong development of new emerging applications in areas such as wireless communications, solid-state storage, digital TV and video products and games;
- the increasing importance of the Asia Pacific region, particularly in China, and other emerging countries, which represents the fastest growing regional markets;
- the importance of convergence between wireless, consumer and computer applications, which drives customer demand to seek new system-level, turnkey solutions from semiconductor suppliers;
- the evolution of the customer base from original equipment manufacturers ( OEM ) to a mix of OEM, electronic manufacturing service providers ( EMS ) and original design manufacturers ( ODM );
- the expansion of available manufacturing capacity through third-party providers; and
- the recent consolidation process and increased participation of private equity firms, which may lead to further strategic repositionings and reorganization amongst industry players.

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

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

*Product innovation.* We aim to be leaders in multimedia convergence and power applications. In order to serve these segments, our plan is to maintain and further establish existing leadership positions for (i) platforms and chipset solutions for digital consumer, mobile handsets and car navigation; and (ii) power applications, which are driving system solutions for customer specific applications, as well as a wide client base in the field of industrial applications, motor control, factory automation, lighting, power supply and automotive, all of which require less research and development effort and manufacturing capital intensity than more advanced and complex application-specific devices.

We also dedicate significant resources to new product development. We have identified our key product offerings in each of the targeted market segments and have concentrated our R&D resources to develop leading-edge products for each. Examples include: digital-base band and multi-media solutions for wireless, digital consumer products focused on set-top boxes and digital TVs, SoC offerings in data storage and system-oriented products for the multisegment sector. We are also targeting new end markets, such as medical applications.

Finally, we have decided to strategically reposition our participation in the Flash memory business in order to achieve the appropriate economies of scale which are demanded in this competitive segment, which will also result in reducing our exposure to the capital intensity of the industry.

*Customer-based initiatives.* There are three tenets to our sales strategy. First, we work with our key customers to identify evolving needs and new applications and to develop innovative products and product features. We have formal alliances with certain strategic customers that allow us and our customers (with whom we jointly share certain product developments) to exchange information and which give our customers access to our process technologies and manufacturing infrastructure. We have formed alliances with customers including Alcatel-Lucent, Bosch, Hewlett-Packard, Marelli, Nokia, Nortel, Pioneer, Seagate, Continental AG, Thomson and Western Digital. Our strategic alliances have been historically a major growth driver for us. In 2005, 2006 and 2007, revenues from strategic customer alliances accounted for approximately 44%, 41% and 40% respectively of our net revenues. Secondly, we are targeting new major key accounts, where we can leverage our position as a supplier of application-specific products with a broad range product portfolio to better address the requirements of large users of semiconductor products with whom our penetration has historically been quite low. Finally, we have

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targeted the mass market, or those customers outside of our traditional top 50 customers, who require system-level solutions for multiple market segments. In addition, we have focused on two regions as key ingredients in our future sales growth, Greater China and Japan, where we have recently launched new marketing initiatives.

*Global integrated manufacturing infrastructure.* We have a diversified, leading-edge manufacturing infrastructure, comprising front-end and back-end facilities, capable of producing silicon wafers using our broad process technology portfolio, including our CMOS, BiCMOS and BCD technologies as well as our discretes technologies. Assembling, testing and packaging of our semiconductor products take place in our large and modern back-end facilities, which generally are located in low-cost areas. We have also developed relationships with outside contractors for foundry and back-end services.

*Reduced asset intensity.* While confirming our mission to remain an integrated device manufacturing company, and in conjunction with our decision to pursue the strategic repositioning of our Flash memories to meet the requirements of the market, we have recently decided to reduce our capital intensity in order to optimize opportunities between internal and external front-end production, reduce our dependence on market cycles that impact the loading of our fabs, and decrease the burden of depreciation on our financial performance. We have been able to reduce the capex-to-sales ratio from a historic average of 26% of sales during the period of 1995 through 2004, to 11.4% of sales in 2007, with a target at about 10% of sales in 2008.

*Research and development partnerships.* The semiconductor industry is increasingly characterized by higher costs and technological risks involved in the research and development of state-of-the-art processes. These higher costs and technological risks have driven us to enter into cooperative partnerships, in particular for the development of basic CMOS technology: specifically, following the decision of Freescale Semiconductor and NXP Semiconductors to terminate their participation in the Crolles2 Alliance for the development of the CMOS process technology at the end of December 2007, we reached an agreement with IBM to collaborate on the development of CMOS process technology for 32-nm and 22-nm nodes. We remain convinced that the shared R&D business development model contributes to the fast acceleration of semiconductor process technology development, and we therefore remain committed to our strategy of our alliances to reinforce cooperation in the area of technology development. Additionally, we maintain our commitment to develop proprietary derivatives from advanced CMOS technology. Furthermore, we are continuing our development in the proprietary process technologies in order to maintain our leadership in Smart Power, analog, discretes, MEMS and mixed signal processes.

*Integrated presence in key regional markets.* We have sought to develop a competitive advantage by building an integrated presence in each of the world s economic zones that we target: Europe, Asia, China and America. An integrated presence means having design and sales and marketing capabilities in each region, in order to ensure that we are well positioned to anticipate and respond to our customers business requirements. We also have front-end manufacturing facilities in the U.S., Europe and Asia. Our more labor-intensive back-end facilities are located in Malaysia, Malta, Morocco, Singapore and China, enabling us to take advantage of more favorable production cost structures, particularly lower labor costs. Major design centers and local sales and marketing groups are within close proximity of key customers in each region, which we believe enhances our ability to maintain strong relationships with our customers.

*Product quality excellence.* We aim to develop the quality excellence of our products and in the various applications we serve and we have launched a company-wide Product Quality Awareness program built around a three-pronged approach: (i) the improvement of our full product cycle involving robust design and manufacturing, improved detection of potential defects, and better anticipation of failures through improved risk assessment, particularly in the areas of product and process changes; (ii) improved responsiveness to customer demands; and (iii) ever increasing focus on quality and discipline in execution.

*Sustainable Excellence and Compliance.* In 2007, we launched a program focusing on sustainable excellence and compliance. Ethics training deployed through all levels of our organizations are based on our Principles for Sustainable Excellence ( PSE ) which require us to integrate and execute all of our business activities, focusing on our employees, customers, shareholders and global business partners. Further, we introduced a process to enable our employees to report matters relating to ethics violations through a confidential reporting line and we formed an Ethics Committee, whose mandate is to provide advice to management and employees about our Principles for Sustainable Excellence and other ethical issues. We also created the position of Chief Compliance Officer in December 2007.

*Return on capital employed.* We remain focused on providing our shareholders with value creation, specifically measured in terms of return on net assets in excess of our weighted average cost of capital.

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**Products and Technology**

We design, develop, manufacture and market a broad range of products used in a wide variety of microelectronic applications, including telecommunications systems, computer systems, consumer goods, automotive products and industrial automation and control systems. Our products include discretes, memories and standard commodity components, ASICs (full custom devices and semicustom devices) and ASSPs for analog, digital, and mixed-signal applications. Historically, we have not produced dynamic random access memory ( DRAMs ) or x86 microprocessors, despite seeking to develop or acquire the necessary IP to use them as components in our SoC solutions.

In 2007, we ran our business along product lines and managed our revenues and internal operating income performance based on the following product segments:

ASG;

IMS; and

FMG.

We also design, develop, manufacture and market subsystems and modules for a wide variety of products in the telecommunications, automotive and industrial markets in our Subsystems division. Based on its immateriality, we do not report information separately for Subsystems.

***Application Specific Product Groups***

The Application Specific Product Groups ( ASG ) is responsible for the design, development and manufacture of application-specific products, as well as mixed analog/digital semicustom-devices, using advanced bipolar, CMOS, BiCMOS mixed-signal and power technologies. The businesses in the ASG offer complete system solutions to customers in several application markets. All products are ASSPs, full-custom or semicustom devices that may also include digital signal processor ( DSP ) and microcontroller cores. The businesses in the ASG particularly emphasize dedicated Integrated Circuits ( ICs ) for automotive, computer peripherals, consumer and certain industrial application segments, as well as for mobile and fixed communication, computing and networking application segments.

Our businesses in the ASG work closely with customers to develop application-specific products using our technologies, intellectual property, and manufacturing capabilities. The breadth of our customer and application base provides us with a better source of stability in the cyclical semiconductor market.

The ASG is comprised of four product lines Mobile, Multimedia & Communications Group ( MMC ) Home Entertainment and Displays Group ( HED ), Computer Peripherals Group ( CPG ), and our Automotive Products Group ( APG ).

***Mobile, Multimedia and Communications Group***

This product line encompasses our largest application segment: telecommunications, and contains four divisions, serving telecommunications products.

(i) *Wireless Multimedia Division.* We focus our product offerings on mobile handsets serving several major OEMs, with a combination of application specific ICs as well as a growing capability in our platform offering. In this market we are strategically positioned in energy management, audio coding and decoding functions ( CODEC ) and radio frequency ICs. We estimate that we ship over 30%, by volume, of the mobile-phone industry s primary

energy-management devices and audio ICs. We are transitioning from ICs to modular solutions in the field of radio frequency and energy management for 3G handsets. In December 2006, we announced a major design win for an ASIC solution for use in 3G/3.5G digital basebands at Ericsson Mobile Platforms. This award represents a significant new product category for us. Furthering our presence in the digital baseband field, in November 2007 we acquired 185 design engineers and certain intellectual property in the wireless field from Nokia, as part of our multifaceted agreement related to 3G chipset development for production beginning in 2010. We also have developed a product offering in the application processor segment known as the Nomadik family, addressing the market for multimedia application processor chips. These products are designed for smart- and feature-based mobile phones, portable wireless products and other applications including automotive entertainment and navigation, and digital consumer products, and the chips are being sampled by a wide range of potential customers. We have design wins at Nokia, Samsung and LG.

(ii) *Imaging Division.* We focus on the wireless handset image-sensor market. We are in production of CMOS-based camera modules and processors for low-and-high density pixel resolutions, which also meet the auto

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focus, advanced fixed focus and miniaturization requirements of this market. In certain situations, we will also sell leading-edge sensors. We have cumulatively shipped hundreds of millions of CMOS camera-phone solutions since entering this market in 2003. We believe that we are one of the leading camera module providers in 2007.

(iii) *Connectivity Division.* To respond to the market need for increased functionality of handsets, we created the Connectivity Division to address wireless LAN ( WLAN ), Bluetooth and connectivity requirements. Our product offerings include WLAN and Bluetooth and Bluetooth/FM radio combination chips designed for low power consumption and a small form factor. We have multiple design wins and are in volume production for several customers in Asia and Europe for our products. In particular, we are manufacturing in volume our single-chip WLAN, Bluetooth and combination ICs for several customers, including a tier-one cell phone manufacturer. Our next generation of ICs increase combination chip offerings with single-die multi-function capability in 65-nm.

(iv) *Communications Infrastructure Division.* This division provides solutions for the wireless and wireline infrastructure segments Our wireline telecommunications products, both ASIC and ASSP, are used in telephone sets, modems, subscriber line interface cards ( SLICs ) for digital central office switching equipment and the high-speed electronic and optical communications networks. In the wireless field we focus on ASIC market due to our many years of experience in the fields of digital baseband chip, radio frequency and mixed-signal products, having recently closed our design activity in the wireless infrastructure ASSP market.

***Home Entertainment and Displays Group***

Our Home Entertainment Group ( HED ) addresses product requirements for the digital consumer application market and has four divisions.

(i) *Home Video Division.* This division focuses on products for digital retail, satellite, cable and IPTV set-top box products and digital television offerings. We continue to expand our product offerings and customer base by introducing solutions for the set-top box market with features such as web-browsing, digital video recording and time-shifting capabilities. In 2007, we further reinforced our historical market leadership in set-top box back-end decoders with the introduction of the STi710x series of products, the latest member of our OMEGA family of set-top box decoder solutions. This 90-nm family of single-chip SoC devices address the fast growing high-definition market, performs at an advanced speed and has enhanced graphics and security features as well as integrated DVR capability, while retaining compatibility with our earlier products. We continue to strengthen our product offerings by addressing software solutions supporting multiple codes, including DVB-MHP (Java) and Microsoft Windows Media based systems.

Our latest product, the STi7109, is our second-generation H.264 high-definition TV ( HDTV ) AVC and VC-1 decoder. Building on the success of the STi710x, the world s first single-chip AVC and MPEG-2 decoder, the STi7109 adds VC-1 decoding, improved security, connectivity features, and support for emerging DVD formats and security standards. These products are being deployed for satellite, IPTV, and terrestrial broadcast by several operators, including Canal+, France Telecom and Telecom Italia. The successor products, the STi7111 and the STi7200, both single-chip dual-decode devices in 65-nm technology, are now being sampled by customers.

We address the digital television markets with a wide range of highly integrated ASSPs and application-specific microcontrollers. Significant numbers of televisions integrating digital terrestrial capability using the STi55xx family as digital plug-in solutions have been sold, primarily in Europe. We acquired Genesis Microchip on January 17, 2008 and will integrate the company s intellectual property, products and personnel into this division and the Home Display Division in 2008. We expect to significantly improve our integrated television product offering as a result of this integration.

(ii) *Interactive System Solutions Division.* We offer customers and partners the capability to jointly develop highly integrated solutions for their consumer products. We utilize a broad and proven base of expertise, advanced technologies and hardware/software intellectual property to provide best-in-class differentiated products for a select base of customers and markets.

(iii) *Home Display Division.* This division offers products aimed at the analog TV market, switches and sound processors as well as CRT monitors. Our products cover driver chips for the flat-panel industry and CRT applications. Our product development is focused mainly on driver chips for various kinds of flat-panel display technologies used in small and large LCDs, having curtailed our efforts in drivers for Plasma and small screen applications in 2007. These products use proprietary technologies fitting the various electrical parameters required by those market segments, ranging from low to very high voltages and currents and from junction to oxide isolation (SOI).

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(iv) *Audio Division.* We design and manufacture a wide variety of components for use in audio applications. Our audio products include audio power amplifiers, audio processors and graphic-equalizer ICs. We recently introduced a family of class D audio amplifier offerings aimed primarily at home, desktop and mobile applications with digital-to-digital complete system solution capability that improve sound quality while reducing power consumption, size and cost.

*Computer Peripherals Group*

(i) *Data Storage Division.* We produce SoCs and analog ASICs for several data storage applications, specializing in disk drives with advanced solutions for read/write-channels, disk controllers, host interfaces, digital power processing, motor controllers and micromachinery. We believe that based on sales, we are, and have been for many years, one of the largest semiconductor companies supplying the hard disk drive market.

Complementing our strong position in SoCs, we believe we are the market leader in motor controllers and we are providing solutions for all market segments, including enterprise, desktop and mobile applications. We are currently providing SoC solutions based on proprietary IP in production at 130-nm and 90-nm for desktop, mobile and server applications. We also supply a kit including a SoC disk controller and a motion-control power combo to a leading maker of drives for mobile applications. A market leader in the data storage market selected our latest 65-nm SoC for its next generation of drives, which we expect to begin shipping in volume in 2009. This SoC includes a rich variety of our own IP including our proprietary read/write channel, Serial ATA controller and microcomputer core.

(ii) *Printer Division.* We are focusing on inkjet and multifunction printer components and are an important supplier of pen chips, motor drivers, and head drivers, digital engines, including those in high performance photo-quality applications and digital color copiers. We are also expanding our offerings to include a reconfigurable ASSP product family, known as SPEAr (Structured Processor Enhanced Architecture), designed for flexibility and ease-of-use by printer manufacturers. We have successfully validated and released our SPEAr Head, a new member of our SPEAr family of configurable SoCs that address various applications, including digital engines for printers, scanners, and other embedded-control applications. Additionally in this area, our partnership with one of our major customers expanded with two new digital engine designs wins in next-generation printer and MultiFunction platforms.

(iii) *Microfluidics Division.* This division builds on the years of our success in microfluidic product design, developed primarily for the inkjet print-head product line, and expands our offering into related fields, such as molecular and health diagnostics. As a result, we announced an agreement with MobiDiag to create a complete system for genomic-based detection of infectious diseases based on our silicon MEMS Lab-on-Chip technology and with Veredus for the detection of Avian Flu.

*Automotive Products Group*

Our automotive products include alternator regulators, airbag controls, anti-skid braking systems, vehicle stability control, ignition circuits, injection circuits, multiplex wiring kits and products for body and chassis electronics, engine management, instrumentation systems, car radio and multimedia, as well as car satellite and navigation systems. We hold a leading position in the IC market for automotive products. We have developed a joint initiative with Freescale Semiconductor for the development of 90-nm embedded Flash technology and common products based on cost-effective 32-bit microcontrollers for use in all automotive applications.

(i) *Powertrain and Safety Division.* From engine and transmission control to mechanical-electronic solutions, microelectronics are steadily pervading all sectors of the automotive industry. Our robust family of automotive products, including MEMS accelerometers, complete standard solutions for DC-motor control and automotive grade 16-bit microcontrollers with embedded Flash memory provide a broad range of features that enhance performance,

safety and comfort while reducing the environmental impact of the automobile.

(ii) *Car Body Division.* We manufacture products for the body and chassis electronics requirements of the car. These products range from microcontrollers used in lighting, door and window/wiper applications to junction boxes, power solutions, dashboards and climate-control needs.

(iii) *Car Radio and Multimedia Division.* We provide auto manufacturers with full solutions for analog and digital car radio solutions for tolling, navigation and other telematic applications. The increasingly complex requirements of the car/driver interface have opened a market for us in the area of car multimedia to include products based on our Nomadik platform of multimedia processors. We have the know-how and experience to offer to the market complete telematics solutions, which include circuits for GPS navigation, voice recognition, audio amplification and audio signal processing.

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(iv) *Digital Broadcast Radio Division.* Our products are used by the fast-growing satellite radio segment. We provide a number of components to this application, including base-band products for the reception of signals by the market leaders. Our penetration in the digital satellite broadcast market is growing with the success of the two American providers.

***Industrial and Multisegment Sector***

The Industrial and Multisegment Sector ( IMS ) is responsible for the design, development and manufacture of discrete power devices, (power transistors and other discrete power devices), standard linear and logic ICs, and radio frequency products. In addition, this segment spearheads our ongoing efforts to maintain and develop high-end analog products and of consolidating our world leadership position in power applications, with full solutions centered around microcontroller applications. This segment is organized into two groups: Analog Power and MEMS ( APM ) and Microcontrollers, Memories and Smartcards ( MMS ).

***APM***

(i) *Power MOSFET Division.* We design, manufacture and sell Power MOSFETs (Metal-Oxide-Silicon Field Effect Transistors) ranging from 20 to 1000 volts for most of the switching applications on the market today. Our products are particularly well suited for high voltage switch-mode power supplies and lighting applications, where we hold a leadership position from low-power, high-volume consumer to high-power industrial applications.

(ii) *Power Bipolar, IGBT and RF Division.* Our bipolar power transistors are used in a variety of voltage applications, including television/monitor horizontal deflection circuits, lighting systems and high power supplies. Our family of ESBT (Emitter Switch Bipolar Transistor) is suitable for very high current very high voltage applications, such as welding machines and PFC (Power Factor Corrector) devices. The IGBT transistors are well suited for automotive applications, such as motor control and high-voltage electronic-ignition actuators. Within this Division we also supply RF transistors used in television broadcasting transmission systems, radars, telecommunications systems and avionic equipment.

(iii) *ASD and IPAD Division.* This division offers a full range of rectifiers, protection thyristors (silicon controlled rectifiers or SCRs and three-terminal semiconductors or Triacs for controlling current in either direction) and other protection devices. These components are used in various applications, including telecommunications systems (telephone sets, modems and line cards), household appliances and industrial systems (motor-control and power-control devices). More specifically, rectifiers are used in voltage converters and regulators and protection devices, while thyristors vary current flows through a variety of electrical devices, including lamps and household appliances. We are leaders in a highly successful range of new products built with our proprietary Application Specific Discrete ( ASD™) technology, which allows a variety of discrete components (diodes, rectifiers, thyristors) to be merged into a single device optimized for specific applications such as electromagnetic interference filtering for cellular phones. Additionally, we are leaders in electronic devices integrating both passive and active components on the same chip, also known as Integrated Passive and Active Devices ( IPAD ), which are widely used in the wireless handset market.

(iv) *Linear and Interface Division.* We offer a broad product portfolio of linear and switching regulators along with operational amplifiers, comparators, and serial and parallel interfaces covering a variety of applications like decoders, DC-DC converters and mobile phones.

(vi) *Industrial and Power Conversion Division.* We design and manufacture products for industrial automation systems, lighting applications (lamp ballast), battery chargers and Switched Mode Power Supplies ( SMPS ). Our key products are power ICs for motor controllers and read/write amplifiers, intelligent power ICs for spindle motor control

and head positioning in hard disk drives and battery chargers for portable electronic systems, including mobile handsets.

(vii) *Advanced Analog and Logic Division.* We develop innovative, differentiated and value-added analog products for a number of markets and applications including point-of-sales terminals, power meters and white goods. We recently introduced our NEATSwitch portfolio of application-specific analog, digital, and power switches and extended our supervisor and reset-IC family. We also produce a variety of HCMOS logic device families, which include clocks, registers, gates, latches and buffers. Such devices are used in a variety of applications, including portable computers, computer networks and telecommunications systems.

(viii) *Micro-electronic-mechanical systems ( MEMS ).* We manufacture these unique mechanical devices for a wide variety of applications where real-world input is required. Our product line includes three-dimensional accelerometers for use in gaming, disk drives and mobile phone devices.

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***MMS***

*(i) Microcontroller Division.* We offer a wide range of 8-, 16- and 32-bit microcontrollers suitable for a wide variety of applications from those where a minimum cost is a primary requirement to those that need powerful real-time performance and high-level language support. These products are manufactured in processes capable of embedding EPROM, EEPROM and Flash nonvolatile memories as appropriate. In 2007, we added to our product offering the STM 32 family of 32-bit Flash microcontrollers based on an advanced ARM Cortex™ M3 core.

(ii) *Memory Division.* We believe we are the world s number one supplier of serial nonvolatile memories that can be electronically rewritten. They are used for perimeter storage in various electronic devices used in all market segments. We manufacture our EEPROMs with sub-micron technology that delivers world-class performance and serves as a reference in the industry. Our EEPROM portfolio ranges from 1-Kb to 1-Mb devices delivered in innovative packages. This division also manufactures application-specific devices, RFID chips and legacy EPROM products.

(iii) *Smartcard IC Division.* Smartcards are card devices containing ICs that store data and provide an array of security capabilities. They are used in a wide and growing variety of applications, including public pay-telephone systems, cellular telephone systems and banks, as well as pay television systems and ID/passport cards. Other applications include medical record applications, card-access security systems, toll-payment and secure transactions over the Internet applications. We have a long track record of leadership in Smartcard ICs. Our expertise in security is a key to our leadership in the finance and pay-TV segments and development of IT applications. In addition, our mastering of the nonvolatile memory technologies is instrumental to offering the highest memory sizes (128 KBytes and even to 1 MByte), particularly important to address the emerging high-end mobile phone market.

(vi) *Incard Division.* The division develops, manufactures and sells plastic cards (both memory and microprocessor based) for banking, identification and telecom applications. Incard operates as a standalone organization and also directly controls the sales force for this product offering.

***Flash Memories Group***

The Flash Memories Group ( FMG ) designs, develops and manufactures a broad range of semiconductor memory products. Flash memory technology, which is one of the enablers of digital convergence, is the core of our nonvolatile memory activity. The products developed by the various divisions are complementary and are addressing different functions and/or market segments.

In December 2006, we announced our decision to establish a stand-alone FMG. This group consolidates all of our Flash memory operations including NAND and NOR Flash memories technology R&D, all product related activities, front-end manufacturing, marketing and sales worldwide. This strategic repositioning of Flash memories was designed to allow for potential industry consolidation and dimension of scale which we view as a necessity to compete successfully in this business.

Our memory business is comprised as follows:

(i) *Wireless Flash Memories Division.* Wireless applications have very specific requirements in power consumption, packaging and memory capabilities. We offer a very wide portfolio of wireless NOR Flash memories from single-die low-density products through high-density 2-Gbit solutions, as well as multiple chip packages containing several memory technology components.

(ii) *Imbedded Nor Division.* We pioneered the concept of serial Flash. This division develops products used in computer, automotive and consumer applications utilizing parallel NOR and Serial Flash technology. Serial Flash

allows integration of up to 64 Mbit and 128 Mbit in an 8-pin package for a large variety of applications.

(iii) *NAND Flash and Storage Media Division.* In 2004, we began offering NAND Flash memory products pursuant to a co-development and manufacturing agreement with Hynix Semiconductor Inc. ( Hynix Semiconductor ). Our efforts are targeted at the lower density memory requirements evolving for embedded wireless applications. Our most advanced offering, a single die 8 Gigabit ( Gbit ) NAND Flash manufactured in 57-nm technology, is now available in production. NAND Flash is primarily used to store information such as music, still pictures, video and data files in a variety of consumer applications, including mobile phones, MP3 readers, universal serial bus ( USB ) keys and digital still cameras.

We have made significant progress on improving the cost position of our FMG segment, in particular widely developing the two-bit-per-cell architecture and transitioning to more advanced technologies, and will continue to

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seek to enhance our competitive position on all fronts of the memory market we serve both by adding new products and improving manufacturing costs.

We expect to deconsolidate this group with the closing of the Numonyx transaction planned for the first quarter of 2008. From that point forward, our Flash memory exposure will consist of our 48.6% equity interest in Numonyx and will be reported in the Earnings/Loss on equity investments line item on our consolidated statement of Income, and certain financing arrangements.

**Strategic Alliances with Customers and Industry Partnerships**

We believe that strategic alliances with customers and industry partnerships are critical to success in the semiconductor industry. We have entered into several strategic customer alliances, including alliances with Alcatel-Lucent, Bosch, Hewlett-Packard, Marelli, Nokia, Nortel, Pioneer, Seagate, Continental AG, Thomson and Western Digital. Customer alliances provide us with valuable systems and application know-how and access to markets for key products, while allowing our customers to share some of the risks of product development with us and to gain access to our process technologies and manufacturing infrastructure. We are actively working to expand the number of our customer alliances, targeting OEMs in the United States, in Europe and in Asia and our recently announced digital base-band relationship with Ericsson Mobile Platform is an example of our success in formalizing this program.

Partnerships with other semiconductor industry manufacturers permit costly research and development and manufacturing resources to be shared to mutual advantage for joint technology development. We have a long history of partnership for the collaborative development of CMOS process technologies in Crolles, France. Since January 1, 2008, we are collaborating with IBM on the development of 32-nm and 22-nm CMOS process technologies. We will pursue the development, with IBM, of CMOS derivatives in Crolles. This cooperation follows the termination at the end of 2007 of the cooperation with Freescale Semiconductor and NXP Semiconductors for the joint research and development of advanced CMOS process technology on 300-mm wafers, as well as for the operations of a 300-mm wafer pilot line fab which has been built in Crolles2. We remain convinced that the shared R&D business model contributes to the fast acceleration of semiconductor process technology development and we will continue to actively pursue an expansion of our portfolio of alliances to reinforce cooperation in the area of technology development in Crolles2.

We have also established joint development programs with leading suppliers such as Air Liquide, Applied Materials, ASM Lithography, Canon, Hewlett-Packard, KLA-Tencor, LAM Research, MEMC, Teradyne and Siltronics and with electronic design automation ( EDA ) tool producers, including Cadence, Co-Ware and Synopsys. We also participate in joint European research programs, such as the MEDEA+ and ITEA programs, and cooperate on a global basis with major research institutions and universities. In 2007 we were a founding member of SOI (Silicon-on-Insulator) Industry Consortium.

We participated in the definition of the New Eureka program named CATRENE and to the European Nanoelectronics Initiative Advisory ( ENIAC ) programs definition.

In 2004, we signed and announced a joint venture agreement with Hynix Semiconductor to build a front-end memory-manufacturing facility in Wuxi City, China, and we plan to contribute this asset to Numonyx.

**Customers and Applications**

We design, develop, manufacture and market thousands of products that we sell to thousands of customers. Our major customers include Alcatel-Lucent, Bosch, Cisco, Conti, Delphi, Delta, Denso, Ericsson, Hewlett-Packard, LG

Electronics, Marelli, Maxtor, Motorola, Nintendo, Nokia, Philips, Pioneer, Samsung, Seagate, Sharp, Siemens, Thomson and Western Digital. To many of our key customers we provide a wide range of products, including application-specific products, discrete devices, memory products and programmable products. Our position as a strategic supplier of application-specific products to certain customers fosters close relationships that provide us with opportunities to supply such customers requirements for other products, including discrete devices, programmable products and memory products. We also sell our products through distributors and retailers, including Arrow Electronics, Avnet, BSI Semiconductor, Future Electronics, Wintech and Yosun.

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The following table sets forth certain of our significant customers and certain applications for our products:

| | | | | |
|---|---|---|---|---|
| **Telecommunications** | | | | |
| Customers: | 2Wire | Huawei | Nortel Networks | Sharp |
| | Alcatel-Lucent | LG Electronics | Research in Motion | Siemens |
| | Cisco | Motorola | Safran | SIRF |
| | Finisar | Nokia | Samsung | Sony Ericsson |
| Applications: | Camera modules/mobile imaging | | Portable multimedia | |
| | Central office switching systems | | Telephone terminals (wireline and wireless) | |
| | Data transport (routing, switching for electronic and optical networks) | | Wireless connectivity (Bluetooth, WLAN, FM radio) | |
| | Cellular telephones | | Wireless infrastructure | |
| | Internet access (XDSL) | | | |
| | Imaging | | | |
| **Computer Peripherals** | | | | |
| Customers: | Agilent | Delta | Intel | Seagate |
| | Apple | Eastman Kodak | Lexmark | Taiwan-Liteon |
| | BenQ | Epson | Microsoft | Western Digital |
| | Dell | Hewlett-Packard | Samsung | Xilinx |
| Applications: | Data storage | | Power management | |
| | Monitors and displays | | Printers | |
| | | | Webcams | |
| **Automotive** | | | | |
| Customers: | Bosch | Harman | Lear | TRW |
| | Continental | Hella | Marelli | Valeo |
| | Delphi | Hitachi | Pioneer | Visteon |
| | Denso | Kostal | Continental AG | Sirius Satellite Radio |
| Applications: | Airbags | | Global positioning systems Multimedia | |
| | Anti-lock braking systems | | Radio/satellite radio | |
| | Body and chassis electronics | | Telematics | |
| | Engine management systems (ignition and injection) | | Vehicle stability control | |
| **Consumer** | | | | |
| Customers: | ADB | Echostar | Philips | Skyworth |
| | AOC | Hyundai | Safran | Sony |
| | Bose Corporation | LG Electronics | Samsung | Thomson |
| | ChangHong | Nintendo | Scientific Atlanta | Vestel |
| Applications: | Audio processing (CD, DVD, Hi-Fi) | | DVDs | |
| | Analog/digital TVs | | Imaging | |
| | Digital cameras | | Set-top boxes | |
| | Digital music players | | VCRs | |
| | | | Displays | |

**Industrial/Other Applications**

| | | | | |
|---|---|---|---|---|
| Customers: | American Power Conversion | Delta | Giesecke & Devrient | Siemens |
| | Artesyn | Enel | Nagra | Taiwan-Liteon |
| | Astec | Gemalto | NDS | UPEK |
| | Autostrade | General Electric | Philips | Vodafone |
| Applications: | Battery chargers | | MEMS | |
| | Smartcard ICs | | Motor controllers | |
| | Intelligent power switches | | Power supplies | |
| | Industrial automation/control systems | | Switch mode power supplies | |
| | Lighting systems (lamp ballasts) | | | |

In 2007, our largest customer, Nokia, represented approximately 21% of our net revenues, compared to approximately 22% in both 2006 and 2005. No other single customer accounted for more than 10% of our net revenues. Sales to our OEM customers accounted for approximately 80% of our net revenues in 2007, from approximately 81% of our net revenues in 2006 and 82% in 2005. Sales to our top ten OEM customers were approximately 49% of total revenues in 2007, 51% in 2006 and 50% in 2005. We have several large customers, certain of whom have entered into strategic alliances with us. Many of our key customers operate in cyclical businesses and have in the past, and may in the future, vary order levels significantly from period to period. In addition, approximately 20% of our net revenues in 2007 were sold through distributors, compared to 19% in 2006 and 18% in 2005. There can be no assurance that such customers or distributors, or any other customers, will continue to place orders with us in the future at the same levels as in prior periods. See Item 3. Key Information

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Risk Factors Risks Related to Our Operations Disruptions in our relationships with any one of our key customers could adversely affect our results of operations.

**Sales, Marketing and Distribution**

We operate regional sales organizations in Europe, North America, Asia Pacific, Greater China, Japan, and Emerging Markets, which include Latin America, the Middle East and Africa, Europe (non-EU and non-EFTA), Russia and India. For a breakdown of net revenues by product segment and geographic region for each of the three years ended December 31, 2007, see Item 5. Operating and Financial Review and Prospects Results of Operations Segment Information.

The European region is divided into seven business units: automotive, consumer and computers, Smartcard, telecom, EMS, industrial, and distribution. Additionally, for all products, including commodities and dedicated ICs, we actively promote and support the sales of these products through sales force, field application engineers, supply-chain management and customer-service, and technical competence center for system-solutions, with support functions provided locally.

In the North America region, the sales and marketing team is organized into six business units. They are located near major centers of activity for either a particular application or geographic region: automotive (Detroit, Michigan), industrial (Boston, Massachusetts), consumer (Chicago, Illinois), computer and peripheral equipment (San Jose, California and Longmont, Colorado), and RFID, communications (Dallas, Texas) and distribution (Boston, Massachusetts). Each regional business unit has a sales force that specializes in the relevant business sector, providing local customer service, market development and specialized application support for differentiated system-oriented products. This structure allows us to monitor emerging applications, to provide local design support, and to identify new products for development in conjunction with the various product divisions as well as to develop new markets and applications with our current product portfolio. A central product-marketing operation in Boston provides product support and training for standard products for the North American region, while a logistics center in Phoenix, Arizona supports just-in-time delivery throughout North America. In addition, a comprehensive distribution business unit provides product and sales support for the regional distribution network.

In the Asia Pacific region during 2007, sales and marketing segments were managed from our regional sales headquarters in Singapore and organized into seven business units (computer and peripheral, automotive, industrial, home entertainment, communications and mobile multimedia, distribution and EMS) with regional and central support organizations (business management, field quality, HR, Korean country strategic planning and design coordination). We have sales offices in Korea, Malaysia, Thailand, Vietnam and Australia. The Singapore sales organization provides central marketing, customer service, technical support, logistics, an application laboratory and design services for the entire region. In addition, there is a design center in Korea.

On January 1, 2006, we created a sales region, Greater China , which encompasses China, Taiwan and Hong Kong. This sales region is dedicated to sales, design and support resources and is aimed at expanding on our many years of successful participation in this quickly growing market, not only with transnational customers that have transferred their manufacturing to China, but also with domestic customers. This market is expected to grow significantly in the next few years according to industry analysts. In 2007, we grew our sales in Greater China by 7.7% and believe that we were one of the leading semiconductor suppliers in China.

In Japan, the large majority of our sales have historically been made through distributors, as is typical for foreign suppliers to the Japanese market. However, we are now seeking to work more directly with our major customers to address their requirements. We provide marketing and technical support services to customers through sales offices in Tokyo and Osaka. In addition, we have established a design center and application laboratory in Tokyo. The design

center designs custom ICs for Japanese clients, while the application laboratory allows Japanese customers to test our products in specific applications. In 2006, we implemented changes in our organization for Japan and are targeting, by expanding our sales design and support resources, to improve our coverage of this significant market for the products we serve. In 2007, our sales grew by more than 18.7% in Japan, while the Japanese market grew only 5.2%.

Our Emerging Markets organization includes Latin America, the Middle East and Africa, Europe (non-EU and non-EFTA) and Russia as well as our design and software development centers in India.

The sales and marketing activities carried out by our regional sales organizations are supported by the product marketing that is carried out by each product division, which also include product development functions. This matrix system reinforces our sales and marketing activities and our broader strategic objectives. We have initiated a program to expand our customer base. This program s key elements include adding sales representatives, adding regional competence centers and new generations of electronic tools for customer support.

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Except for Emerging Markets, each of our regional sales organizations operates dedicated distribution organizations. To support the distribution network, we operate logistic centers in Saint Genis, France; Phoenix, Arizona and Singapore.

We also use distributors and representatives to distribute our products around the world. Typically, distributors handle a wide variety of products, including products that compete with our products, and fill orders for many customers. Most of our sales to distributors are made under agreements allowing for price protection and/or the right-of-return on unsold merchandise. We generally recognize revenues upon transfer of ownership of the goods at shipment. Sales representatives generally do not offer products that compete directly with our products, but may carry complementary items manufactured by others. Representatives do not maintain a product inventory; instead, their customers place large quantity orders directly with us and are referred to distributors for smaller orders.

At the request of certain of our customers, we are also selling and delivering our products to EMS, which, on a contractual basis with our customers, incorporate our products into the application-specific products which they manufacture for our customers. Certain customers require us to hold inventory on consignment in their hubs and only purchase inventory when they require it for their own production. This may lead to delays in recognizing revenues as such customers may choose within a specific period of time the moment when they accept delivery of our products.

**Research and Development**

We believe that research and development is critical to our success. The main research and development challenge we face is to continually increase the functionality, speed and cost-effectiveness of our semiconductor devices, while ensuring that technological developments translate into profitable commercial products as quickly as possible.

In 2007, underlining our commitment to our research and development efforts, we established a new ST Technology Council composed of 15 leading experts in the field including internationally recognized university professors. The Technology Council is chaired by Robert White, a former member of our Supervisory Board and a professor at Stanford University. The role of the technology council is to meet annually without senior management and leaders of our research and development activities to review, evaluate and advise us on the competitive technical landscape.

We are market driven in our research and development and focused on leading-edge products and technologies developed in close collaboration with strategic alliance partners, leading universities and research institutions, key customers and global equipment manufacturers working at the cutting edge of their own markets. Front-end manufacturing and technology R&D, while being separate organizations, are under the responsibility of the Chief Operating Officer, thereby ensuring a smooth flow of information between the R&D and manufacturing organizations. The research and development activities relating to new products are managed by the Product Segments and consist mainly of design activities.

In 2005, we reallocated approximately 10% of our research and development resources in favor of higher priority projects for both process technology development and product design with the aim to increase the efficiency of our research and development activity and accelerate product innovation.

We continue to make significant investments in research and development and we intend to increase our focus on innovative product development. In 2007, we spent $1,802 million on research and development, which represented approximately a 8% increase from $1,667 million in 2006, while 2006 spending represented a 2% increase from $1,630 million in 2005. The table below sets forth information with respect to our research and development spending since 2005. Our reported research and development expenses are mainly in product design, technology and development and do not include marketing and design-center costs which are accounted for as selling expenses, or process engineering, pre-production and process-transfer costs, which are accounted for as cost of sales:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | (In millions, except percentages) | | |
| Expenditures | $ 1,802 | $ 1,667 | $ 1,630 |
| As a percentage of net revenues | 18.0% | 16.9% | 18.3% |

Approximately 85% of our research and development expenses in 2007 were incurred in Europe, primarily in France and Italy. See Public Funding below. As of December 31, 2007, we employed approximately 10,570 employees in research and development activities worldwide.

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We devote significant effort to R&D because semiconductor manufacturers face immense pressure to be the first to make breakthroughs that can be leveraged into competitive advantages; new developments in semiconductor technology can make end products significantly cheaper, smaller, faster or more reliable than their predecessors and enable, through their timely appearance on the market, significant value creation opportunities.

To ensure that new technologies can be exploited in commercial products as quickly as possible an integral part of our R&D philosophy is concurrent engineering, meaning that new fabrication processes and the tools needed to exploit them are developed simultaneously. Typically, these include not only EAD software, but also cell libraries that allow access to our rich IP portfolio and a demonstrator product suitable for subsequent commercialization. In this way, when a new process is delivered to our product segments or made available to external customers, they are more able to develop commercial products immediately.

Our advanced R&D centers are strategically located around the world, primarily in France (Crolles) and Italy (Agrate), as well as in Italy (Catania), France (Grenoble, Tours and Rousset), the United States (Phoenix, Carrollton, and San Diego), Canada (Ottawa), the United Kingdom (Bristol and Edinburgh), Switzerland (Geneva), India (Noida and Bangalore), China (Beijing, Shenzhen and Shanghai) and Singapore.

From 2002 to December 31, 2007, we cooperated with NXP Semiconductors and Freescale Semiconductor as part of the Crolles2 Alliance to jointly develop sub-micron CMOS logic processes on 300-mm wafers and to operate an advanced 300-mm wafer pilot line in Crolles, France. Effective January 1, 2008, we began working with IBM and its partners under an agreement to co-develop 32-nm and 22-nm core CMOS at IBM s East Fiskill (United States) facility as well as to continue to develop with IBM state-of-the-art derivative technologies (defined as RF CMOS, Power CMOS and CMOS Imaging) at Crolles2. We may in the future add new partners to strengthen the cooperative activities in Crolles2.

In addition, our manufacturing facility in Crolles, France houses a research and development center that is operated in the legal form of a French *Groupement d intérêt économique* named Centre Commun de Microelectronique de Crolles. Laboratoire d Electronique de Technologie d Instrumentation ( LETI ), a research laboratory of Commissariat à l Energie Atomique ( CEA ), an affiliate of Areva Group (one of our indirect shareholders), is our partner.

There can be no assurance that we will be able to develop future technologies and commercially implement them on satisfactory terms, or that our alliances will allow the successful development of state-of-the-art core or derivative CMOS technologies on satisfactory terms. See Item 3. Key Information Risk Factors Risks Related to Our Operations Our research and development efforts are increasingly expensive and dependent on alliances, and our business, results of operations and prospects could be materially adversely affected by the failure or termination of such alliances, or failure to find new partners in such alliance, or in developing new process technologies in line with market requirements.

The Agrate R2 activity encompasses prototyping, pilot and volume production of the newly developed technologies with the objective to accelerate process industrialization and time-to-market for Smart power affiliation (BCD) and MEMS, in addition to certain memory products.

Our intellectual property design center in Noida, India supports all of our major design activities worldwide and hosts a major central R&D activity focused on software and core libraries development, with a strong emphasis on system solutions. Our corporate technology R&D teams work in a wide variety of areas that offer opportunities to harness our deep understanding of microelectronics and our ability to synthesize knowledge from around the world. These include:

Soft Computing, in which a variety of problem-solving techniques such as fuzzy logic, neural networks and genetic algorithms are applied to situations where the knowledge is inexact or the computational resources required to obtain a complete solution would be excessive using traditional computing architectures. Potential applications include more effective automotive engine control, emerging fuel-cell technology and future quantum-computing techniques that will offer much greater computational speeds than are currently achievable;

Nano-Organics, which encompasses a variety of emerging technologies that deal with structures smaller than the deep sub-micron scale containing as little as a few hundred or thousand atoms. Examples include carbon nanotubes, which have potential applications in displays and memories, and all applications that involve electronic properties of large molecules such as proteins; and

Micro-Machining, in which the ability to precisely control the mechanical attributes of silicon structures is exploited. There are many potential applications, including highly sensitive pressure and acceleration sensors, miniature microphones, microfluidic devices and optical devices. In addition, along with its optical

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properties, the mechanical properties of silicon represent one of the most important links between conventional SoC technology and all the new technologies such as bioelectronics that can benefit from our semiconductor expertise.

The fundamental mission of our Advanced System Technology ( AST ) organization is to create system knowledge that supports our SoC development. AST s objective is to develop the advanced architectures that will drive key strategic applications, including digital consumer, wireless communications, computer peripherals and Smartcards, as well as the broad range of emerging automotive applications such as car multimedia. The group has played a key role in establishing our pre-eminence in mobility, connectivity, multimedia, storage and security, the core competences required to drive today s convergence markets.

AST s challenge is to combine the expertise and expectations of our customers, industrial and academic partners, our central R&D teams and product segments to create a cohesive, practical vision that defines the hardware, software and system integration knowledge that we will need in the next three to five years and the strategies required to master them. AST has eight large laboratories around the world, plus a number of smaller locations located near universities and research partners. Its major laboratories are located in: Agrate Brianza; Catania; Castelletto; Geneva; Grenoble; Lecce; Noida; Portland, Oregon; Rousset; and San Diego, California.

We also have divisional R&D centers such as those in Castelletto, Catania and Tours that carry out more specialized work that benefits from their close relationship to their markets. For example, Castelletto pioneered the BCD process that created the world smart-power market and has developed advanced MEMS technologies used to build products such as inkjet printheads, accelerometers and the world s first single chip microarray for DNA amplification and detection.

The ASD™ technology developed at Tours has allowed ST to bring to the market numerous products that can handle high bi-directional currents, sustain high voltages or integrate various discrete elements in a single chip, like the IPADs. ASD technology has proved increasingly successful in a variety of telecom, computer and industrial applications: ESD protection and AC switching are key areas together with RF filter devices.

The Catania facility hosts a wide range of R&D activities and its major divisional R&D achievements in recent years include the development of our revolutionary PowerMESH™ and STripFET™ MOSFET families.

Our other specialized divisional R&D centers are located in Grenoble (packaging R&D, IP center), and Rousset (Smartcard and microcontroller development), in addition to a host of centers focusing on providing a complete system approach in digital consumer applications, such as TVs, DVD players, set-top boxes and cameras. These centers are located in various locations including: Beijing; Bristol; Carrollton, Texas; Edinburgh; Grenoble; Noida; Rousset; and Singapore. For Smartcard SoC, we have centers in Prague and Shanghai.

All of these worldwide activities create new ideas and innovations that enrich our portfolio of intellectual property and enhance our ability to provide our customers with winning solutions.

Furthermore, an array of important strategic customer alliances ensures that our R&D activities closely track the changing needs of the industry, while a network of partnerships with universities and research institutes around the world ensures that we have access to leading-edge knowledge from all corners of the world. We also play leadership roles in numerous projects running under the European Union s IST (Information Society Technologies) programs. We actively participate in these programs and continue collaborative R&D efforts within the MEDEA+ research program.

Finally, we believe that platforms are the answer to the growing need for full system integration, as customers require from their silicon suppliers not just chips, but an optimized combination of hardware and software. More than 1,500

engineers and designers are currently developing platforms we selected to spearhead our future growth in some of the fastest developing markets of the microelectronics industry. The platforms include Application Processors, namely our Nomadik platform that is bringing multimedia to the next-generation mobile devices, set-top boxes/integrated digital TV, which include the promising new wave of high-definition images, and in the area of computer peripherals, the SPEAr family of reconfigurable SoC ICs for printers and related applications.

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**Property, Plants and Equipment**

We currently operate 15 (as per table below) main manufacturing sites around the world. The table below sets forth certain information with respect to our current manufacturing facilities, products and technologies. Front-end manufacturing facilities are wafer fabrication plants, known as fabs, and back-end facilities are assembly, packaging and final testing plants. Some of these fabs where Flash memory production is concerned are earmarked to be transferred to Numonyx, our pending joint venture with Intel.

| Location | Products | Technologies |
|---|---|---|
| **Front-end facilities** | | |
| Crolles1, France | Application-specific products, image sensors | Fab: 200-mm CMOS and BiCMOS, Analog/RF, imaging |
| Crolles2, France(1) | Application-specific products and leading edge logic products | Fab: 300-mm research and development on deep sub-micron (90-nm and below) CMOS and differentiated SoC technology development, TSV pilot line |
| Phoenix, Arizona (identified for closure) | Application-specific products and microcontrollers | Fab: 200-mm CMOS, BiCMOS, BCD, microcontrollers |
| Agrate, Italy | Nonvolatile memories, microcontrollers and application-specific products MEMS Smart power | Fab 1: 200-mm BCD, nonvolatile memories, MEMS<br>Fab 2: 200-mm Flash, embedded Flash, research and development on nonvolatile memories and BCD technologies |
| Rousset, France | Microcontrollers, nonvolatile memories and Smartcard ICs, application-specific products and image sensors | Fab 1: 150-mm CMOS, Smartcard (shut down March 2007)<br>Fab 2: 200-mm CMOS, Smartcard, embedded Flash, imaging |
| Catania, Italy | Power transistors, Smart Power ICs and nonvolatile memories | Fab 1: 150-mm Power metal-on silicon oxide semiconductor process technology ( MOS ),VIPpower and Pilot Line RF<br>Fab 2: 200-mm Flash, Smartcard, EEPROM BCD<br>Fab 4: 300-mm building constructed but not fully facilitized and equipped |
| Tours, France | Protection thyristors, diodes and ASD power transistors, IPAD | Fab: 125-mm, 150-mm and 200-mm pilot line discrete |
| Ang Mo Kio, Singapore | Analog, microcontrollers, power transistors, commodity products, nonvolatile memories, and application-specific products | Fab 1: 125-mm, power MOS, bipolar, power<br>Fab 2: 150-mm bipolar, power MOS and BCD, EEPROM, Smartcard, Micros, CMOS logic<br>Fab 3: 200-mm, Flash memories |

| | | |
|---|---|---|
| | | Fab 4: 150 mm Microfluidic, MEMS, BCD, BiCMOS, CMOS |
| Carrollton, Texas (identified for closure) | Application-specific products, MEMS, Microfluidics | Fab: 150-mm BiCMOS, BCD and CMOS |
| **Back-end facilities** | | |
| Muar, Malaysia | Application-specific and standard products, microcontrollers, Flash | |
| Kirkop, Malta | Application-specific products | |
| Toa Payoh, Singapore | Nonvolatile memories and power ICs under reconversion into an EWS center | |
| Ain Sebaa, Morocco (identified for closure) | Discrete and standard products | |
| Bouskoura, Morocco | Nonvolatile memories, discrete and standard products, micromodules, RF and subsystems | |
| Shenzhen, China(2) | Nonvolatile memories, discrete and standard products | |

(1) Operated jointly with NXP Semiconductors and Freescale Semiconductor. The agreement terminated at the end of 2007.

(2) Jointly operated with SHIC, a subsidiary of Shenzhen Electronics Group.

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At the end of 2007, our front-end facilities had total capacity of approximately 125,000 200-mm equivalent wafer starts per week. The number of wafer starts per week varies from facility to facility and from period to period as a result of changes in product mix. We have seven 200-mm wafer production facilities currently in operation. Of these, four (at Crolles, France; Agrate, Italy; Catania, Italy; and Phoenix, Arizona) have full design capacity installed as of December 31, 2007; as of the same date, fabs (in Rousset, France and in Singapore) have approximately two-thirds of the ultimate capacity installed. Some of our facilities where we manufacture flash memory products have been earmarked for transfer to Numonyx, upon closing of our announced transaction with Intel and Francisco Partners in the field of Flash Memory Products.

Our advanced 300-mm wafer pilot-line fabrication facility in Crolles, France produced approximately 2,500 wafers per week at the end of 2007 and we may in the future increase production as required by market conditions.

We own all of our manufacturing facilities, except Crolles2, France, which is the subject of a capital lease for the building shell only.

We have historically subcontracted a portion of total manufacturing volumes to external suppliers. Our goal is to reduce our capital investment spending to sales ratio from above 20% in previous years to a target of approximately 10%, due to the change in the structural growth of the semiconductor market which has moved from double to single digit over the last ten years. The reduction in our capital investments is also designed to reduce our dependence on economic cycles which affects the loading of our fabs and to decrease the burden of depreciation on our financial performance while optimizing opportunities between internal and external front-end production.

As of December 31, 2007, we had $683 million in outstanding commitments for purchases of equipment and other assets for delivery in 2008. The most significant of our 2008 capital expenditure projects are expected to be: (a) for the front-end facilities: (i) full capacity ownership of our 300-mm fab in Crolles, through the purchase of the Alliance partners tools; (ii) a specific program of capacity growth devoted to MEMS in Agrate (Italy) and mixed technologies in Agrate and Catania (Italy) to support the significant growth opportunity in these technologies; (iii) focused investment both in manufacturing and R&D in France sites to secure and develop our system oriented proprietary technologies portfolio (HCMOS derivatives and mixed signal) required by our strategic customers; and (b) for the back-end facilities, the capital expenditures will mainly be dedicated to the technology evolution to support the ICs path to package size reduction in Shenzhen (China) and Muar (Malaysia) and to prepare for future years capacity growth by completing the new production area in Muar and the new plant in Longgang (China). In the last five years, we have closed six manufacturing plants globally and upgraded one production line. In addition, we have announced the closure plans for three more manufacturing sites as well as the transfer to Numonyx of four sites.

Our manufacturing processes are highly complex, require advanced and costly equipment and are continuously being modified in an effort to improve yields and product performance. Impurities or other difficulties in the manufacturing process can lower yields, interrupt production or result in losses of products in process. As system complexity has increased and sub-micron technology has become more advanced, manufacturing tolerances have been reduced and requirements for precision and excellence have become even more demanding. Although our increased manufacturing efficiency has been an important factor in our improved results of operations, we have from time to time experienced production difficulties that have caused delivery delays and quality control problems, as is common in the semiconductor industry.

No assurance can be given that we will be able to increase manufacturing efficiency in the future to the same extent as in the past or that we will not experience production difficulties in the future.

As is common in the semiconductor industry, we have from time to time experienced difficulty in ramping up production at new facilities or effecting transitions to new manufacturing processes and, consequently, have suffered delays in product deliveries or reduced yields. There can be no assurance that we will not experience manufacturing problems in achieving acceptable yields, product delivery delays or interruptions in production in the future as a result of, among other things, capacity constraints, production bottlenecks, construction delays, equipment failure or maintenance, ramping up production at new facilities, upgrading or expanding existing facilities, changing our process technologies, or contamination or fires, storms, earthquakes or other acts of nature, any of which could result in a loss of future revenues. In addition, the development of larger fabrication facilities that require state-of-the-art sub-micron technology and larger-sized wafers has increased the potential for losses associated with production difficulties, imperfections or other causes of defects. In the event of an incident leading to an interruption of production at a fab, we may not be able to shift production to other facilities on a timely basis, or our customers may decide to purchase products from other suppliers, and, in either case, the loss of revenues and the impact on our relationship with our customers could be significant. Our operating results could also be adversely affected by the increase in our fixed costs and operating expenses related to increases in production capacity if

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revenues do not increase commensurately. Finally, in periods of high demand, we increase our reliance on external contractors for foundry and back-end service. Any failure to perform by such subcontractors could impact our relationship with our customers and could materially affect our results of operations.

**Intellectual Property**

Intellectual property rights that apply to our various products include patents, copyrights, trade secrets, trademarks and mask work rights. A mask work is the two or three-dimensional layout of an integrated circuit. We own close to 19,000 patents or pending patent applications which have been registered in several countries around the world and correspond to more than 9,000 patent families (each patent family containing all patents originating from the same invention). We filed 497 new patent applications around the world in 2007.

Our success depends in part on our ability to obtain patents, licenses and other intellectual property rights covering our products and their design and manufacturing processes. To that end, we intend to continue to seek patents on our circuit designs, manufacturing processes, packaging technology and other inventions. The process of seeking patent protection can be long and expensive, and there can be no assurance that patents will issue from currently pending or future applications or that, if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. In addition, effective copyright and trade-secret protection may be unavailable or limited in certain countries. Competitors may also develop technologies that are protected by patents and other intellectual property rights and therefore such technologies may be unavailable to us or available to us subject to adverse terms and conditions. Management believes that our intellectual property represents valuable assets and intends to protect our investment in technology by enforcing all of our intellectual property rights. We have used our patent portfolio to enter into several broad patent cross-licenses with several major semiconductor companies enabling us to design, manufacture and sell semiconductor products without fear of infringing patents held by such companies, and intend to continue to use our patent portfolio to enter into such patent cross-licensing agreements with industry participants on favorable terms and conditions. As our sales increase compared to those of our competitors, the strength of our patent portfolio may not be sufficient to guarantee the conclusion or renewal of broad patent cross-licenses on terms which do not affect our results of operations. Furthermore, as a result of litigation, or to address our business needs, we may be required to take a license to third-party intellectual property rights upon economically unfavorable terms and conditions, and possibly pay damages for prior use, and/or face an injunction or exclusion order, all of which could have a material adverse effect on our results of operations and ability to compete.

From time to time, we are involved in intellectual property litigation and infringement claims. See Item 8. Financial Information Legal Proceedings. In the event a third-party intellectual property claim were to prevail, our operations may be interrupted and we may incur costs and damages, which could have a material adverse effect on our results of operations, cash flow and financial condition.

Finally, we have received from time to time, and may in the future receive communications from competitors or other parties alleging infringement of certain patents and other intellectual property rights of others, which has been and may in the future be followed by litigation. Regardless of the validity or the successful assertion of such claims, we may incur significant costs with respect to the defense thereof, which could have a material adverse effect on our results of operations, cash flow or financial condition. See Item 3. Key Information Risk Factors Risks Related to Our Operations We depend on patents to protect our rights to our technology.

**Backlog**

Our sales are made primarily pursuant to standard purchase orders that are generally booked from one to twelve months in advance of delivery. Quantities actually purchased by customers, as well as prices, are subject to variations between booking and delivery and, in some cases, to cancellation due to changes in customer needs or industry

conditions. During periods of economic slowdown and/or industry overcapacity and/or declining selling prices, customer orders are not generally made far in advance of the scheduled shipment date. Such reduced lead time can reduce management s ability to forecast production levels and revenues. When the economy rebounds, our customers may strongly increase their demands, which can result in capacity constraints due to our inability to match manufacturing capacity with such demand.

In addition, our sales are affected by seasonality, with the first quarter generally showing lowest revenue levels in the year, and the third or fourth quarter generating the highest amount of revenues due to electronic products purchased from many of our targeted market segments for the holiday period.

We also sell certain products to key customers pursuant to frame contracts. Frame contracts are annual contracts with customers setting forth quantities and prices on specific products that may be ordered in the future.

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These contracts allow us to schedule production capacity in advance and allow customers to manage their inventory levels consistent with just-in-time principles while shortening the cycle times required to produce ordered products. Orders under frame contracts are also subject to a high degree of volatility, because they reflect expected market conditions which may or may not materialize. Thus, they are subject to risks of price reduction, order cancellation and modifications as to quantities actually ordered resulting in inventory build-ups.

Furthermore, developing industry trends, including customers use of outsourcing and their deployment of new and revised supply chain models, may reduce our ability to forecast changes in customer demand and may increase our financial requirements in terms of capital expenditures and inventory levels.

Following the industry-wide over-inventory situation and the declining level of order bookings in the second half of 2004, we entered 2005 with an order backlog (defined here to include frame orders) that was lower than we had entering 2004. During 2005, our backlog registered a solid increase. We entered 2006, with a backlog higher than we had entering 2005, and, due to a more difficult industry environment, we entered 2007 with an order backlog lower than what we had entering 2006. We are entering 2008 with a backlog significantly higher compared to 2007 due to good order flow in the last quarter of 2007. However, based on the current outlook for the world economy, or if the demand for semiconductors were to be reduced, we cannot guarantee that our outstanding backlog will result in revenues during 2008.

**Competition**

Markets for our products are intensely competitive. While only a few companies compete with us in all of our product lines, we face significant competition in each of our product lines. We compete with major international semiconductor companies, some of which may have substantially greater financial and other more focused resources than we do with which to pursue engineering, manufacturing, marketing and distribution of their products. Smaller niche companies are also increasing their participation in the semiconductor market, and semiconductor foundry companies have expanded significantly, particularly in Asia. Competitors include manufacturers of standard semiconductors, ASICs and fully customized ICs, including both chip and board-level products, as well as customers who develop their own IC products and foundry operations. Some of our competitors are also our customers.

The primary international semiconductor companies that compete with us include Analog Devices, Broadcom, Hynix, IBM, Infineon Technologies, Intel, International Rectifier, Fairchild Semiconductor, Freescale Semiconductor, Linear Technology, LSI Logic, Marvell Technology Group, Maxim Integrated Products, Microchip Technology, National Semiconductor, Nippon Electric Company, NXP Semiconductors, ON Semiconductor, NXP Semiconductors, Qualcomm, Renesas, Samsung, Spansion, Texas Instruments and Toshiba.

We compete in different product lines to various degrees on the basis of price, technical performance, product features, product system compatibility, customized design, availability, quality and sales and technical support. In particular, standard products may involve greater risk of competitive pricing, inventory imbalances and severe market fluctuations than differentiated products. Our ability to compete successfully depends on elements both within and outside of our control, including successful and timely development of new products and manufacturing processes, product performance and quality, manufacturing yields and product availability, customer service, pricing, industry trends and general economic trends.

**Organizational Structure and History**

We are a multinational group of companies that designs, develops, manufactures and markets a broad range of products used in a wide variety of microelectronic applications, including telecommunications systems, computer systems, consumer goods, automotive products and industrial automation and control systems. We are organized in a

matrix structure with geographical regions interacting with product divisions, both being supported by central functions, bringing all levels of management closer to the customer and facilitating communication among research and development, production, marketing and sales organizations.

While STMicroelectronics N.V. is the parent company, we also conduct our operations through our subsidiaries. With the exception of our subsidiaries in Shenzhen, China, in which we own 60% of the shares and voting rights; Hynix, ST (China), a joint venture company, in which we own a 17% equity participation; Shanghai Blue Media Co. Ltd (China), in which we own 65%; and Incard do Brazil, in which we own 50% of the shares and voting rights, STMicroelectronics N.V. owns directly or indirectly 100% of all of our significant operating subsidiaries shares and voting rights, which have their own organization and management bodies, and are operated independently in compliance with the laws of their country of incorporation. We provide certain administrative, human resources, legal, treasury, strategy, manufacturing, marketing and other overhead services to our consolidated subsidiaries pursuant to service agreements for which we receive compensation.

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The following list includes our principal subsidiaries and equity investments and the percentage of ownership we held as of December 31, 2007:

| Legal Seat | Name | Percentage Ownership (Direct or Indirect) |
|---|---|---|
| Australia Sydney | STMicroelectronics PTY Ltd | 100 |
| Belgium Zaventem | STMicroelectronics Belgium N.V. | 100 |
| Belgium Zaventem | Proton World International N.V. | 100 |
| Brazil Sao Paolo | STMicroelectronics Ltda | 100 |
| Brazil Sao Paulo | Incard do Brazil Ltda | 50 |
| Canada Ottawa | STMicroelectronics (Canada), Inc. | 100 |
| China Jiangsu(1) | Hynix-ST Semiconductor Ltd | 17 |
| China Shenzhen | Shenzhen STS Microelectronics Co. Ltd | 60 |
| China Shenzhen | STMicroelectronics (Shenzhen) Co. Ltd | 100 |
| China Shenzhen | STMicroelectronics (Shenzhen) Manufacturing Co. Ltd | 100 |
| China Shenzhen | STMicroelectronics (Shenzhen) R&D Co. Ltd | 100 |
| China Shanghai | STMicroelectronics (Shanghai) Co. Ltd | 100 |
| China Shanghai | STMicroelectronics (Shanghai) R&D Co. Ltd | 100 |
| China Shanghai | Shanghai Blue Media Co. Ltd | 65 |
| China Shanghai | STMicroelectronics (China) Investment Co. Ltd | 100 |
| China Beijing | STMicroelectronics (Beijing) R&D Co. Ltd | 100 |
| Czech Republic Prague | STMicroelectronics Design and Application s.r.o. | 100 |
| Finland Lohja | STMicroelectronics OY | 100 |
| Finland Helsinki | STMicroelectronics R&D OY | 100 |
| France Crolles | STMicroelectronics (Crolles 2) SAS | 100 |
| France Montrouge | STMicroelectronics S.A. | 100 |
| France Rousset | STMicroelectronics (Rousset) SAS | 100 |
| France Tours | STMicroelectronics (Tours) SAS | 100 |
| France Grenoble | STMicroelectronics (Grenoble) SAS | 100 |
| Germany Grasbrunn | STMicroelectronics GmbH | 100 |
| Germany Grasbrunn | STMicroelectronics Design and Application GmbH | 100 |
| Holland Amsterdam | STMicroelectronics Finance B.V. | 100 |
| Hong Kong Hong Kong | STMicroelectronics LTD | 100 |
| India Noida | STMicroelectronics Pvt Ltd | 100 |
| India New Delhi | STMicroelectronics Marketing Pvt Ltd | 100 |
| Israel Netanya | STMicroelectronics Ltd | 100 |
| Italy Caivano(1) | INGAM S.r.l. | 20 |
| Italy Catania | CO.RI.M.ME. | 100 |
| Italy Aosta | DORA S.p.a. | 100 |
| Italy Agrate Brianza | ST Incard S.r.l. | 100 |
| Italy Naples | STMicroelectronics Services S.r.l. | 100 |
| Italy Agrate Brianza | STMicroelectronics S.r.l. | 100 |
| Italy Agrate Brianza | STMicroelectronics (Memory) S.r.l. | 100 |
| Japan Tokyo | STMicroelectronics KK | 100 |
| Malaysia Kuala Lumpur | STMicroelectronics Marketing SDN BHD | 100 |
| Malaysia Muar | STMicroelectronics SDN BHD | 100 |

| | | | |
|---|---|---|---|
| Malaysia | Muar | STMicroelectronics (Memory) Sdn Bhd | 100 |
| Malta | Kirkop | STMicroelectronics Ltd | 100 |
| Mexico | Guadalajara | STMicroelectronics Marketing, S. de R.L. de C.V. | 100 |
| Mexico | Guadalajara | STMicroelectronics Design and Applications, S. de R.L. de C.V. | 100 |
| Morocco | Rabat | Electronic Holding S.A. | 100 |
| Morocco | Casablanca | STMicroelectronics S.A. | 100 |
| Singapore | Ang Mo Kio | STMicroelectronics ASIA PACIFIC Pte Ltd | 100 |
| Singapore | Ang Mo Kio | STMicroelectronics Pte Ltd | 100 |
| Singapore | Ang Mo Kio | STMicroelectronics (Memory) Pte Ltd | 100 |
| Singapore | Ang Mo Kio | STMicroelectronics ASIA PACIFIC (Memory) Pte Ltd | 100 |
| Spain | Madrid | STMicroelectronics S.A. | 100 |
| Sweden | Kista | STMicroelectronics A.B. | 100 |
| Switzerland | Geneva | STMicroelectronics S.A. | 100 |
| Switzerland | Geneva | INCARD S.A. | 100 |
| Switzerland | Geneva | INCARD Sales and Marketing S.A. | 100 |
| Turkey | Istanbul | STMicroelectronics Elektronik Arastirma ve Gelistirme Anonim Sirketi | 100 |
| United Kingdom | Marlow | STMicroelecrtonics Limited | 100 |
| United Kingdom | Marlow | STMicroelectronics (Research & Development) Limited | 100 |
| United Kingdom | Bristol | Inmos Limited | 100 |
| United Kingdom | Reading | Synad Technologies Limited | 100 |
| United States | Carrollton | STMicroelectronics Inc. | 100 |
| United States | Wilmington | STMicroelectronics (North America) Holding, Inc. | 100 |
| United States | Wilsonville | The Portland Group, Inc. | 100 |

(1) Equity Investments

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**Public Funding**

We participate in certain programs established by the EU, individual countries and local authorities in Europe (principally France and Italy). Such funding is generally provided to encourage research and development activities, industrialization and the economic development of underdeveloped regions. These programs are characterized by direct partial support to research and development expenses or capital investment or by low-interest financing.

Public funding in France, Italy and Europe generally is open to all companies, regardless of their ownership or country of incorporation, for research and development and for capital investment and low-interest-financing related to incentive programs for the economic development of under-developed regions. The EU has developed model contracts for research and development funding that require beneficiaries to disclose the results to third parties on reasonable terms. As disclosed, the conditions for receipt of government funding may include eligibility restrictions, approval by EU authorities, annual budget appropriations, compliance with European Commission regulations, as well as specifications regarding objectives and results.

Some of our government funding contracts for research and development involve advance payments that requires us to justify our expenses after receipt of funds. Certain specific contracts (Crolles2, Rousset, France and Catania, Italy) contain obligations to maintain a minimum level of employment and investment during a certain amount of time. There could be penalties (partial refund) if these objectives are not fulfilled. Other contracts contain penalties for late deliveries or for breach of contract, which may result in repayment obligations. However, the obligation to repay such funding is never automatic.

The main programs for research and development in which we are involved include: (i) the Micro-Electronics Development for European Application ( MEDEA+ ) cooperative research and development program; (ii) EU research and development projects with FP6 and FP7 (Sixth and Seventh Frame Program) for Information Technology; and (iii) national or regional programs for research and development and for industrialization in the electronics industries involving many companies and laboratories. The pan-European programs cover a period of several years, while national or regional programs in France and Italy are subject mostly to annual budget appropriation.

The MEDEA+ cooperative research and development program was launched in June 2000 by the Eureka Conference and is designed to bring together many of Europe s top researchers in a 12,000 man-year program that covers the period 2001-2008 in two phases of four years each. The MEDEA+ program replaced the joint European research program called MEDEA, which was a European cooperative project in microelectronics among several countries that covered the period 1996 through 2000 and involved more than 80 companies. With a program duration of eight years, MEDEA+ will conclude at the end of 2008. The new EUREKA strategic initiative, called CATRENE ( Cluster for Application and Technology Research in Europe on NanoElectronics , launched October 25, 2007, builds on the highly successful European MEDEA+ nanoelectronics programme) will start in January 2008, with the first call for project proposals expected in the first half of 2008.

In Italy, there are some national funding programs established to support the FIST (*Fondo per gli Investimenti nella Ricerca Scientifica e Tecnologica*) that groups previous funding regulations (FIRB, *Fondo per gli Investimenti della Ricerca di Base,* aimed to fund fundamental research, and FAR, *Fondo per le Agevolazioni alla Ricerca,* to fund industrial research), and the FCS (*Fondo per la Competitivita e lo Sviluppo*) that replaces FIT (*Fondo per l Innovazione Tecnologica,* to fund precompetitive development). These programs are not limited to microelectronics and are suitable to support industry R&D in any segment. Italian programs often cover several years and the approval phase is quite long, up to two/three years. During 2004, submissions for FAR and FIT were suspended for new projects, including the MEDEA+ projects whose Italian activities are subject to FAR rules and availability. In July 2005, however, the Italian Government began considering funding new projects related to limited strategic

programmes in areas it had selected. One of these areas was semiconductors. The company submitted 7 proposals which are expected to be approved in the first half of 2008. In July 2007 a call was launched on FCS (specifically for Better Efficiency in Energy and Sustainable Mobility ) where we submitted 9 proposals. Furthermore, there are some regional funding tools that can be addressed by local initiatives, primarily in the regions of Puglia and Val D Aosta, provided that a reasonable regional socio-economic impact could be recognized in terms of industrial exploitation, new professional hiring and/or cooperation with local academia and public laboratories.

In a decision on December 6, 2006 sent to the Italian Foreign Minister, the EU Commission accepted to modify the conditions of a grant, which was originally approved in 2002 for an amount of 542.3 million (Decision N844/2001), representing approximately 26.25% of the total cost (estimated at 2,066 million) (the M6 Grant ) for the building, facilitization and equipment of a new 300-mm manufacturing facility in Catania M6 capable of producing approximately 5,000 wafers per week for nonvolatile memory products (the M6 Plant ).

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

In France, support for microelectronics is provided to over 30 companies with activities in the semiconductor industry. The amount of support under French programs is decided annually and subject to budget appropriation. We also plan to benefit from the new French law on Credit Impot Recherche which increases the amount of tax deductible R&D expenses.

In accordance with SEC Statement Accounting Bulletin No. 104 *Revenue Recognition* (SAB 104) and our revenue recognition policy, funding related to these contracts is booked when the conditions required by the contracts are met. Our funding programs are classified in three general categories for accounting purposes: funding for research and development activities, funding for research and development capital investments, and loans.

Funding for research and development activities is the most common form of funding that we receive. Public funding for research and development is recorded as Other Income and Expenses, net in our consolidated statements of income. Public funding for research and development is booked pro rata in relation to the relevant cost once the agreement with the applicable government agency has been signed and as any applicable conditions are met. See Note 20 to our Consolidated Financial Statements. Such funding has totaled $97 million, $54 million and $76 million in the years 2007, 2006 and 2005, respectively.

Government support for capital expenditures funding has totaled $9 million, $15 million and $38 million in the years 2007, 2006 and 2005, respectively. Such funding has been used to support our capital investment. Although receipt of these funds is not directly reflected in our results of operations, the resulting lower amounts recorded in property, plant and equipment costs reduce the level of depreciation recognized by us. Public funding reduced depreciation charges by $33 million, $54 million and $66 million in 2007, 2006 and 2005, respectively.

As a third category of government funding, we receive some loans, mainly related to large capital investment projects, at preferential interest rates. We recognize these loans as debt on our consolidated balance sheet in accordance with paragraph 35 of Statements of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (CON 6). Low interest financing has been made available (principally in Italy) under programs such as the Italian Republic s Fund for Applied Research, established in 1988 for the purpose of supporting Italian research projects meeting specified program criteria. At year-end 2007, 2006 and 2005, we had approximately $150 million, $125 million and $120 million, respectively, of indebtedness outstanding under state-assisted financing programs at an average interest cost of 2.4%, 0.9% and 1.0%, respectively.

Funding of programs in France and Italy is subject to annual appropriation, and if such governments or local authorities were unable to provide anticipated funding on a timely basis or if existing government- or local-authority-funded programs were curtailed or discontinued, or if we were unable to fulfill our eligibility requirements, such an occurrence could have a material adverse effect on our business, operating results and financial condition. Furthermore, we may need to rely on public funding as we transition to 300-mm manufacturing technology. We are dependent on public funding for equipping the 300-mm wafers production facility in Catania (Italy). If such planned funding does not materialize, we may lack financial resources to continue with our investment plan for this facility, which in turn could lead us to discontinue our investment in such facility and consequentially incur significant impairments. From time to time, we have experienced delays in the receipt of funding under these programs. As the availability and timing of such funding are substantially outside our control, there can be no assurance that we will continue to benefit from such government support, that funding will not be delayed from time to time, that sufficient alternative funding would be available if necessary or that any such alternative funding would be provided on terms as favorable to us as those previously committed.

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Due to changes in legislation and/or review by the competent administrative or judicial bodies, there can be no assurance that government funding granted to us may not be revoked or challenged or discontinued in whole or in part, by any competent state or European authority, until the legal time period for challenging or revoking such funding has fully lapsed. See Item 3. Key Information Risk Factors Risks Related to Our Operations Reduction in the amount of public funding available to us, changes in existing public funding programs or demands for repayment may increase our costs and impact our results of operations.

**Suppliers**

We use three main critical types of suppliers in our business: equipment suppliers, raw material suppliers and external subcontractors.

In the front-end process, we use steppers, scanners, tracking equipment, strippers, chemo-mechanical polishing equipment, cleaners, inspection equipment, etchers, physical and chemical vapor-deposition equipment, implanters, furnaces, testers, probers and other specialized equipment. The manufacturing tools that we use in the back-end process include bonders, burn-in ovens, testers and other specialized equipment. The quality and technology of equipment used in the IC manufacturing process defines the limits of our technology. Demand for increasingly smaller chip structures means that semiconductor producers must quickly incorporate the latest advances in process technology to remain competitive. Advances in process technology cannot be brought about without commensurate advances in equipment technology, and equipment costs tend to increase as the equipment becomes more sophisticated.

Our manufacturing processes use many raw materials, including silicon wafers, lead frames, mold compound, ceramic packages and chemicals and gases. The prices of many of these raw materials are volatile. We obtain our raw materials and supplies from diverse sources on a just-in-time basis. Although supplies for the raw materials used by us are currently adequate, shortages could occur in various essential materials due to interruption of supply or increased demand in the industry. See Item 3. Key Information Risk Factors Risks Related to Our Operations Because we depend on a limited number of suppliers for raw materials and certain equipment, we may experience supply disruptions if suppliers interrupt supply or increase prices.

Finally, we also use external subcontractors to outsource wafer manufacturing and assembly and testing of finished products. See Property, Plants and Equipment above. We also have an agreement with Hynix Semiconductor for the co-development and manufacturing of NAND products pursuant to which Hynix Semiconductor from Korea is supplying the co-developed NAND products to us. We have also set up a joint venture in China which has built and operates a memory manufacturing facility in Wuxi City, China, which entitles us to receive an amount of wafers produced at this facility at competitive conditions and commensurate with our equity interest in the joint venture. This equity interest and the right to receive wafers from the Wuxi City facility is designated to be transferred to Numonyx.

**Environmental Matters**

Our manufacturing operations use many chemicals, gases and other hazardous substances, and we are subject to a variety of evolving environmental and health and safety regulations related, among other things, to the use, storage, discharge and disposal of such chemicals and gases and other hazardous substances, emissions and wastes, as well as the investigation and remediation of soil and ground water contamination. In most jurisdictions in which we operate, our manufacturing activities are subject to obtaining permits, licenses or other authorizations, or to prior notification. Because a large portion of our manufacturing activities are located in the EU, we are subject to European Commission regulation on environmental protection, as well as regulations of the other jurisdictions where we have operations.

Consistent with our Principles for Sustainable Excellence, we have established proactive environmental policies with respect to the handling of chemicals, gases, emissions and waste disposals from our manufacturing operations, and we have not suffered material environmental claims in the past. We believe that our activities comply with presently applicable environmental regulations in all material respects. We have engaged outside consultants to audit all of our environmental activities and created environmental management teams, information systems and training. We have also instituted environmental control procedures for processes used by us as well as our suppliers. As a company, we have been certified to be in compliance with the quality standard ISO9001:2000 and with the technical specification ISO/TS16949:2002. In addition, all 15 of our manufacturing facilities have been certified to conform to the environmental standard ISO14001, to the Eco Management and Audit Scheme (EMAS) and to the Health and Safety standard OHSAS18001.

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Our activities are subject to two directives adopted on January 27, 2003: Directive 2002/95/EC on the restriction of the use of certain hazardous substances in electrical and electronic equipment ( ROHS Directive, as amended by Commission Decision 2005/618/EC of August 18, 2005) and Directive 2002/96/EC on waste electrical and electronic equipment ( WEEE Directive, as modified by Directive 2003/108/EC of December 8, 2003). Directive 2002/95/EC aims at banning the use of lead and other flame-retardant substances in manufacturing electronic components by July 1, 2006. Directive 2002/96/EC promotes the recovery and recycling of electrical and electronic waste. In France, Directives 2002/95/EC and 2002/96/EC have been implemented by a decree dated July 20, 2005 and five ministerial orders published in November 2005, December 2005 and March 2006. The French scheme for the recovery and recycling of WEEE was officially launched on November 15, 2006.

Our activities in the EU are also subject to the European Directive 2003/87/EC establishing a scheme for greenhouse gas allowance trading (as modified by Directive 2004/101/EC), and the applicable national legislation. Two of our manufacturing sites (Crolles, France, and Agrate, Italy) have been allocated a quota of greenhouse gas for the period 2005-2007. Failure to comply would have forced us to acquire potentially expensive additional emission allowances from third parties, or to pay a fee for each extra ton of gas emitted. This risk did not materialize, since both sites were within the allocated quota at the end of 2007. Our visibility on future emissions confirms this trend, and we do not foresee any significant impact on ST. Our on-going programs to reduce $CO_2$ emissions will allow us to comply with the greenhouse gas quota allocations which have been defined for Crolles and Agrate for the period 2008-2012. In the United States, we participate in the Chicago Climate Exchange program, a voluntary greenhouse gas trading program whose members commit to reduce emissions. During Phase I (2003-2006), emission reduction targets were 1% per year, below the baseline which is an average of annual emissions over the 1998-2001 period. During Phase II (2008-2010), we confirmed our commitment to an additional 2% reduction. The idea is that all members should be 6% below this baseline by 2010. We have also implemented voluntary reforestation projects in several countries in order to sequester additional $CO_2$ emissions.

Furthermore, Regulation 1907/2006 of December 18, 2006 concerning the registration, evaluation, authorization and restriction of chemicals ( REACH ) entered into force on June 1, 2007. Regulations implementing the REACH are in preparation, particularly with regards to fees to be paid by the industry for the registration and authorization of chemical products, as well as test methods. We intend to proactively implement such new legislation, in line with our commitment toward environmental protection.

The implementation of any such legislation could adversely affect our manufacturing costs or product sales by requiring us to acquire costly equipment or materials, or to incur other significant expenses in adapting our manufacturing processes or waste and emission disposal processes. However, we are currently unable to evaluate such specific expenses and therefore have no specific reserves for environmental risks. Furthermore, environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us, suspension of production or a cessation of operations and, as with other companies engaged in similar activities, any failure by us to control the use of, or adequately restrict the discharge of hazardous substances could subject us to future liabilities. See Item 3. Key Information Risk Factors Risks Related to Our Operations Some of our production processes and materials are environmentally sensitive, which could lead to increased costs due to environmental regulations or to damage to the environment. We have identified potential liabilities relating to environmental matters that are reflected on our consolidated balance sheet.

**Industry Background**

***The Semiconductor Market***

Semiconductors are the basic building blocks used to create an increasing variety of electronic products and systems. Since the invention of the transistor in 1948, continuous improvements in semiconductor process and design

technologies have led to smaller, more complex and more reliable devices at a lower cost per function. As performance has increased and size and cost have decreased, semiconductors have expanded beyond their original primary applications (military applications and computer systems) to applications such as telecommunications systems, consumer goods, automotive products and industrial automation and control systems. In addition, system users and designers have demanded systems with more functionality, higher levels of performance, greater reliability and shorter design cycle times, all in smaller packages at lower costs. These demands have resulted in increased semiconductor content as a percentage of system cost. Calculated on the basis of the total available market (the TAM ), which includes all semiconductor products, as a percentage of worldwide revenues from production of electronic equipment according to published industry data, semiconductor content has increased from approximately 12% in 1992 to approximately 21% in 2007.

Semiconductor sales have increased significantly over the long term but have experienced significant cyclical variations in growth rates. According to trade association data, the TAM increased from $45 billion in 1988 to

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$256 billion in 2007 (growing at a compound annual growth rate of approximately 10%). In 2006, the TAM increased by approximately 9% and in 2007 by approximately 3%. On a sequential, quarter-by-quarter basis in 2007 (including actuators), the TAM decreased by approximately 6% in the first quarter over the fourth quarter 2006, while in the second quarter it decreased by approximately 2% over the first quarter, it increased by approximately 13% in the third quarter over the second quarter, and decreased by approximately 1% in the fourth quarter over the third quarter. To better reflect our corporate strategy and our current product offering, we measure our performance against our serviceable available market ( SAM ), redefined as the TAM without DRAMs, microprocessors and optoelectronic products. The SAM increased from approximately $35 billion in 1988 to $174 billion in 2007, growing at a compound annual rate of approximately 9%. The SAM increased by approximately 6% in 2007 compared to 2006. In 2007, approximately 17% of all semiconductors were shipped to the Americas, 16% to Europe, 19% to Japan, and 48% to the Asia Pacific region.

The following table sets forth information with respect to worldwide semiconductor sales by type of semiconductor and geographic region:

| | Worldwide Semiconductor Sales(1) | | | | | | Compound Annual Growth Rates(2) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 1998 | 1988 | 06-07 | 05-06 | 04-05 | 88-07 | 88-98 | 9 |
| | (In billions) | | | | | | (Expressed as percentages) | | | | | |
| d | | | | | | | | | | | | |
| | $ 222.9 | $ 214.8 | $ 197.3 | $ 183.5 | $ 109.1 | $ 35.9 | 3.8% | 8.9% | 7.5% | 10.1% | 11.8% | |
| ensors | | | | | | | | | | | | |
| tors | 41.6 | 42.3 | 36.5 | 36.1 | 19.1 | 7.2 | (1.7) | 16.0 | 0.9 | 9.6 | 10.2 | |
| gic | 123.5 | 114.1 | 112.4 | 100.3 | 67.0 | 17.8 | 8.2 | 1.5 | 12.1 | 10.7 | 14.2 | |
| | 31.3 | 33.8 | 25.6 | 26.8 | 14.0 | 6.3 | (7.4) | 32.0 | (4.7) | 8.8 | 8.3 | |
| | 26.6 | 24.7 | 22.9 | 20.3 | 9.0 | 4.6 | 7.7 | 7.7 | 13.0 | 9.7 | 6.9 | |
| nory | 57.9 | 58.5 | 48.5 | 47.1 | 23.0 | 10.9 | (1.1) | 20.5 | 2.9 | 9.2 | 7.7 | |
| tal | 181.4 | 172.6 | 160.9 | 147.4 | 90.0 | 28.7 | 5.1 | 7.3 | 9.1 | 10.2 | 12.1 | |
| | 16.8 | 16.6 | 15.2 | 15.8 | 11.9 | 7.0 | 1.3 | 8.8 | (3.3) | 4.7 | 5.5 | |
| onics | 15.9 | 16.3 | 14.9 | 13.7 | 4.6 | 2.1 | (2.3) | 9.3 | 8.6 | 11.2 | 8.1 | |
| | $ 255.6 | $ 247.7 | $ 227.5 | $ 213.0 | $ 125.6 | $ 45.0 | 3.2% | 8.9% | 6.8% | 9.6%(3) | 10.8% | |
| | 41.0 | 39.9 | 39.3 | 39.4 | 29.4 | 8.1 | 2.7 | 1.6 | (0.4) | 8.9 | 13.8 | |
| | 42.3 | 44.9 | 40.7 | 39.1 | 41.4 | 13.4 | (5.7) | 10.3 | 4.3 | 6.2 | 11.9 | |
| ic | 123.5 | 116.5 | 103.4 | 88.8 | 28.9 | 5.4 | 6.0 | 12.7 | 16.5 | 17.9 | 18.3 | |
| | 48.8 | 46.4 | 44.1 | 45.8 | 25.9 | 18.1 | 5.2 | 5.3 | (3.7) | 5.4 | 3.7 | |
| | $ 255.6 | $ 247.7 | $ 227.5 | $ 213.0 | $ 125.6 | $ 45.0 | 3.2% | 8.9% | 6.8% | 9.6%(3) | 10.8% | |

(1) Source: WSTS.

(2) Calculated using end points of the periods specified.

(3) Calculated on a comparable basis, without information with respect to actuators as they were not included in the indicator before 2003.

Although cyclical changes in production capacity in the semiconductor industry and demand for electronic systems have resulted in pronounced cyclical changes in the level of semiconductor sales and fluctuations in prices and margins for semiconductor products from time to time, the semiconductor industry has experienced substantial growth over the long term. Factors that are contributing to long-term growth include the development of new semiconductor applications, increased semiconductor content as a percentage of total system cost, emerging strategic partnerships and growth in the electronic systems industry in the Asia Pacific region.

***Semiconductor Classifications***

The process technologies, levels of integration, design specificity, functional technologies and applications for different semiconductor products vary significantly. As differences in these characteristics have increased, the semiconductor market has become highly diversified as well as subject to constant and rapid change. Semiconductor product markets may be classified according to each of these characteristics.

Semiconductors can be manufactured using different process technologies, each of which is particularly suited to different applications. Since the mid-1970s, the two dominant processes have been bipolar (the original technology used to produce ICs) and CMOS. Bipolar devices typically operate at higher speeds than CMOS

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devices, but CMOS devices consume less power and permit more transistors to be integrated on a single IC. CMOS has become the prevalent technology, particularly for devices used in personal computers and consumer applications. Advanced technologies have been developed during the last decade that are particularly suited to more systems-oriented semiconductor applications. BiCMOS technologies have been developed to combine the high-speed and high-voltage characteristics of bipolar technologies with the low power consumption and high integration of CMOS technologies. BCD technologies have been developed that combine bipolar, CMOS and DMOS technologies. Such systems-oriented technologies require more process steps and mask levels, and are more complex than the basic function-oriented technologies.

Semiconductors are often classified as either discrete devices (such as individual diodes, thyristors and transistors, as well as optoelectronic products) or ICs (in which thousands of functions are combined on a single chip of silicon to form a more complex circuit). Compared to the market for ICs, there is typically less differentiation among discrete products supplied by different semiconductor manufacturers. Also, discrete markets have generally grown at slower, but more stable, rates than IC markets.

Semiconductors may also be classified as either standard components, ASSPs or ASICs. Standard components are used for a broad range of applications, while ASSPs and ASICs are designed to perform specific functions in specific applications.

The two basic functional technologies for semiconductor products are analog and digital. Mixed-signal products combine both analog and digital functionality. Analog devices monitor, condition, amplify or transform analog signals, which are signals that vary continuously over a wide range of values.

Analog/digital (or mixed-signal ) ICs combine analog and digital devices on a single chip to process both analog signals and digital data. System designers are increasingly demanding system-level integration in which complete electronic systems containing both analog and digital functions are integrated on a single IC.

Digital devices are divided into two major types: memory products and logic devices. Memory products, which are used in electronic systems to store data and program instructions, are classified as either volatile memories (which lose their data content when power to the device is switched off) or nonvolatile memories (which retain their data content without the need for continuous power).

The primary volatile memory devices are DRAMs, which accounted for approximately 54% of semiconductor memory sales in 2007, and static RAMs ( SRAMs ), which accounted for approximately 4% of semiconductor memory sales in 2007. SRAMs are roughly four times as complex as DRAMs. DRAMs are used in a computer s main memory. SRAMs are principally used as caches and buffers between a computer s microprocessor and its DRAM-based main memory and in other applications such as mobile handsets.

Nonvolatile memories are used to store program instructions. Among such nonvolatile memories, read-only memories ( ROMs ) are permanently programmed when they are manufactured while programmable ROMs ( PROMs ) can be programmed by system designers or end-users after they are manufactured. Erasable PROMs ( EPROMs ) may be erased after programming by exposure to ultraviolet light and can be reprogrammed several times using an external power supply. Electrically erasable PROMs ( EEPROMs ) can be erased byte by byte and reprogrammed in-system without the need for removal.

Flash memories, which accounted for approximately 38% of semiconductor memory sales in 2007, are products that represent an intermediate solution between EPROMs and EEPROMs based on their cost and functionality. Because Flash memories can be erased and reprogrammed electrically and in-system, they are more flexible than EPROMs and are therefore progressively replacing EPROMs in many current applications. Flash memories are typically used in

high volume in digital mobile phones and digital consumer applications (set-top boxes, DVDs, digital cameras, MP3 digital music players) and, because of their ability to store large amounts of information, are also suitable for solid-state mass storage of data and emerging high-volume applications.

Logic devices process digital data to control the operation of electronic systems. The largest segment of the logic market includes microprocessors, microcontrollers and DSPs. Microprocessors are the central processing units of computer systems. Microcontrollers are complete computer systems contained on single ICs that are programmed to specific customer requirements. Microcontrollers control the operation of electronic and electromechanical systems by processing input data from electronic sensors and generating electronic control signals. They are used in a wide variety of consumer, communications, automotive, industrial and computer products. DSPs are parallel processors used for high complexity, high-speed real-time computations in a wide variety of applications.

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## Item 5. Operating and Financial Review and Prospects

### Overview

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto included elsewhere in this Form 20-F. The following discussion contains statements of future expectations and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, or Section 21E of the Securities Exchange Act of 1934, each as amended, particularly in the sections Critical Accounting Policies Using Significant Estimates , Business Outlook and Liquidity and Capital Resources Financial Outlook. Our actual resu may differ significantly from those projected in the forward-looking statements. For a discussion of factors that might cause future actual results to differ materially from our recent results or those projected in the forward-looking statements in addition to the factors set forth below, see Cautionary Note Regarding Forward-Looking Statements and Item 3, Key Information Risk Factors. We assume no obligation to update the forward-looking statements or such risk factors.*

#### *Critical Accounting Policies Using Significant Estimates*

The preparation of our Consolidated Financial Statements, in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ), requires us to make estimates and assumptions that have a significant impact on the results we report in our Consolidated Financial Statements, which we discuss under the section Results of Operations. Some of our accounting policies require us to make difficult and subjective judgments that can affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. The primary areas that require significant estimates and judgments by management include, but are not limited to, sales returns and allowances; reserves for price protection to certain distributor customers; allowances for doubtful accounts; inventory reserves and normal manufacturing loading thresholds to determine costs to be capitalized in inventory; accruals for warranty costs, litigation and claims; assumptions used to discount monetary assets expected to be recovered beyond one year; valuation of acquired intangibles, goodwill, investments and tangible assets as well as the impairment of their related carrying values; estimated value of the consideration to be received and used as fair value for disposal asset group classified as assets to be disposed of by sale; evaluation of the fair value of marketable securities available-for-sale for which no observable market price is obtainable and assessment of any potential impairment; estimates relating to the valuation of business transactions and relevant accounting considerations; restructuring charges; other non-recurring special charges; assumptions used in calculating pension obligations and share-based compensation including assessment of the number of awards expected to vest upon future performance condition achievement; assumptions used to measure and recognize a liability for the fair value of the obligation we assume at the inception of a guarantee; assessment of hedge effectiveness of derivative instruments; deferred income tax assets, including required valuation allowances and liabilities; and provisions for specifically identified income tax exposures and income tax uncertainties. We base our estimates and assumptions on historical experience and on various other factors such as market trends, business plans and levels of materiality that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. While we regularly evaluate our estimates and assumptions, our actual results may differ materially and adversely from our estimates. To the extent there are material differences between the actual results and these estimates, our future results of operations could be significantly affected.

We believe the following critical accounting policies require us to make significant judgments and estimates in the preparation of our Consolidated Financial Statements:

*Revenue recognition.* Our policy is to recognize revenues from sales of products to our customers when all of the following conditions have been met: (a) persuasive evidence of an arrangement exists; (b) delivery has

occurred; (c) the selling price is fixed or determinable; and (d) collectibility is reasonably assured. This usually occurs at the time of shipment.

Consistent with standard business practice in the semiconductor industry, price protection is granted to distributor customers on their existing inventory of our products to compensate them for declines in market prices. The ultimate decision to authorize a distributor refund remains fully within our control. We accrue a provision for price protection based on a rolling historical price trend computed on a monthly basis as a percentage of gross distributor sales. This historical price trend represents differences in recent months between the invoiced price and the final price to the distributor, adjusted if required, to accommodate a significant move in the current market price. The short outstanding inventory time period, visibility into the standard inventory product pricing (as opposed to certain customized products) and long distributor pricing history have enabled us to reliably estimate price protection provisions at period-end. We record the accrued amounts as a deduction of revenue at the time of the sale. If market conditions differ from our assumptions,

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this could have an impact on future periods; in particular, if market conditions were to deteriorate, net revenues could be reduced due to higher product returns and price reductions at the time these adjustments occur.

Our customers occasionally return our products from time to time for technical reasons. Our standard terms and conditions of sale provide that if we determine that products are non-conforming, we will repair or replace the non-conforming products, or issue a credit or rebate of the purchase price. In certain cases, when the products we have supplied have been proven to be defective, we have agreed to compensate our customers for claimed damages in order to maintain and enhance our business relationship. Quality returns are not related to any technological obsolescence issues and are identified shortly after sale in customer quality control testing. Quality returns are always associated with end-user customers, not with distribution channels. We provide for such returns when they are considered as probable and can be reasonably estimated. We record the accrued amounts as a reduction of revenue.

Our insurance policies relating to product liability only cover physical and other direct damages caused by defective products. We do not carry insurance against immaterial, non-consequential damages. We record a provision for warranty costs as a charge against cost of sales based on historical trends of warranty costs incurred as a percentage of sales which we have determined to be a reasonable estimate of the probable losses to be incurred for warranty claims in a period. Any potential warranty claims are subject to our determination that we are at fault and liable for damages, and that such claims usually must be submitted within a short period following the date of sale. This warranty is given in lieu of all other warranties, conditions or terms expressed or implied by statute or common law. Our contractual terms and conditions typically limit our liability to the sales value of the products, which gave rise to the claims.

We maintain an allowance for doubtful accounts for potential estimated losses resulting from our customers inability to make required payments. We base our estimates on historical collection trends and record a provision accordingly. Furthermore, we are required to evaluate our customers credit ratings from time to time and take an additional provision for any specific account that we estimate as doubtful. In 2007, we did not record any new material specific provision related to bankrupt customers in addition to our standard provision of 1% of total receivables based on the estimated historical collection trends. If we receive information that the financial condition of our customers has deteriorated, resulting in an impairment of their ability to make payments, additional allowances could be required.

While the majority of our sales agreements contain standard terms and conditions, we may, from time to time, enter into agreements that contain multiple elements or non-standard terms and conditions, which require revenue recognition judgments. Where multiple elements exist in an arrangement, the arrangement is allocated to the different elements based upon verifiable objective evidence of the fair value of the elements, as governed under Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables ( EITF 00-21 ).

*Goodwill and purchased intangible assets.* The purchase method of accounting for acquisitions requires extensive use of estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development, which is expensed immediately. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are instead subject to annual impairment tests. The amounts and useful lives assigned to other intangible assets impact future amortization. If the assumptions and estimates used to allocate the purchase price are not correct or if business conditions change, purchase price adjustments or future asset impairment charges could be required. At December 31, 2007, the value of goodwill amounted to $290 million.

*Impairment of goodwill.* Goodwill recognized in business combinations is not amortized and is instead subject to an impairment test to be performed on an annual basis, or more frequently if indicators of impairment exist, in order to assess the recoverability of its carrying value. Goodwill subject to potential impairment is tested at a reporting unit level, which represents a component of an operating segment for which discrete financial information is available and is subject to regular review by segment management. This impairment test

determines whether the fair value of each reporting unit for which goodwill is allocated is lower than the total carrying amount of relevant net assets allocated to such reporting unit, including its allocated goodwill. If lower, the implied fair value of the reporting unit goodwill is then compared to the carrying value of the goodwill and an impairment charge is recognized for any excess. In determining the fair value of a reporting unit, we usually estimate the expected discounted future cash flows associated with the reporting unit. Significant management judgments and estimates are used in forecasting the future discounted cash flows including: the applicable industry s sales volume forecast and selling price evolution; the reporting unit s market penetration; the market acceptance of certain new technologies and relevant cost

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structure; the discount rates applied using a weighted average cost of capital; and the perpetuity rates used in calculating cash flow terminal values. Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution, our sales expectations and our costs evaluation and are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect, and future adverse changes in market conditions or operating results of acquired businesses not in line with our estimates may require impairment of certain goodwill. During 2007, we performed our annual review of impairment of goodwill and based on this test no impairment charges were required to be recorded.

*Intangible assets subject to amortization.* Intangible assets subject to amortization include the cost of technologies and licenses purchased from third parties, internally developed software that is capitalized and purchased software. Intangible assets subject to amortization are reflected net of any impairment losses. These are amortized over a period ranging from three to seven years. The carrying value of intangible assets subject to amortization is evaluated whenever changes in circumstances indicate that the carrying amount may not be recoverable. In determining recoverability, we initially assess whether the carrying value exceeds the undiscounted cash flows associated with the intangible assets. If exceeded, we then evaluate whether an impairment charge is required by determining if the asset s carrying value also exceeds its fair value. An impairment loss is recognized for the excess of the carrying amount over the fair value. We normally estimate the fair value based on the projected discounted future cash flows associated with the intangible assets. Significant management judgments and estimates are required and used in the forecasts of future operating results that are used in the discounted cash flow method of valuation, including: the applicable industry s sales volume forecast and selling price evolution; our market penetration; the market acceptance of certain new technologies; and costs evaluation. Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution and our sales expectations and are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect and that future adverse changes in market conditions or operating results of businesses acquired may not be in line with our estimates and may therefore require impairment of certain intangible assets. We recorded $2 million of impairment charges in 2007 on certain technologies following our decision to discontinue our activities using those technologies. At December 31, 2007, the value of intangible assets in our Consolidated Financial Statements subject to amortization amounted to $238 million.

*Property, plant and equipment.* Our business requires substantial investments in technologically advanced manufacturing facilities, which may become significantly underutilized or obsolete as a result of rapid changes in demand and ongoing technological evolution. We estimate the useful life for the majority of our manufacturing equipment, which is the largest component of our long-lived assets, to be six years. This estimate is based on our experience with using equipment over time. Depreciation expense is a major element of our manufacturing cost structure. We begin to depreciate new equipment when it is placed into service.

We evaluate each period when there is reason to suspect that the carrying value of tangible assets or groups of assets might not be recoverable. Factors we consider important which could trigger an impairment review include: significant negative industry trends, significant underutilization of the assets or available evidence of obsolescence of an asset, strategic management decisions impacting production or an indication that its economic performance is, or will be, worse than expected and a more likely than not expectation that assets will be sold or disposed of prior to their estimated useful life. In determining the recoverability of assets to be held and used, we initially assess whether the carrying value exceeds the undiscounted cash flows associated with the tangible assets or group of assets. If exceeded, we then evaluate whether an impairment charge is required by determining if the asset s carrying value also exceeds its fair value. We normally estimate this fair value based on independent market appraisals or the sum of discounted future cash flows, using market assumptions such as the utilization of our fabrication facilities and the ability to upgrade such facilities, change in the selling price and the adoption of new technologies. We also evaluate the

continued validity of an asset s useful life when impairment indicators are identified. Assets classified as held for sale are reflected at the lower of their carrying amount or fair value less selling costs and are not depreciated during the selling period. Selling costs include incremental direct costs to transact the sale that we would not have incurred except for the decision to sell.

Our evaluations are based on financial plans updated with the latest projections of the semiconductor market evolution and of our sales expectations, from which we derive the future production needs and loading of our manufacturing facilities, and which are consistent with the plans and estimates that we use to manage our business. These plans are highly variable due to the high volatility of the semiconductor

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business and therefore are subject to continuous modifications. If the future evolution differs from the basis of our plans, both in terms of market evolution and production allocation to our manufacturing plants, this could require a further review of the carrying amount of our tangible assets resulting in a potential impairment loss. At December 31, 2007, as part of the 2007 manufacturing restructuring plan and of the planned disposal of the FMG assets held for sale, we identified certain tangible assets, mainly equipment, without alternative future use, which generated a charge of $12 million.

*Inventory.* Inventory is stated at the lower of cost or net realizable value. Cost is based on the weighted average cost by adjusting standard cost to approximate actual manufacturing costs on a quarterly basis; the cost is therefore dependent on our manufacturing performance. In the case of underutilization of our manufacturing facilities, we estimate the costs associated with the excess capacity; these costs are not included in the valuation of inventories but are charged directly to cost of sales. Net realizable value is the estimated selling price in the ordinary course of business less applicable variable selling expenses.

The valuation of inventory requires us to estimate obsolete or excess inventory as well as inventory that is not of saleable quality. Provisions for obsolescence are estimated for excess uncommitted inventories based on the previous quarter sales, order backlog and production plans. To the extent that future negative market conditions generate order backlog cancellations and declining sales, or if future conditions are less favorable than the projected revenue assumptions, we could be required to record additional inventory provisions, which would have a negative impact on our gross margin.

*Asset disposal.* On May 22, 2007, we entered into a definitive agreement with Intel Corporation and Francisco Partners L.P. to create a new independent semiconductor company from the key assets of businesses which for our Company had been included in our Flash Memories Group ( FMG ). Upon signature of this agreement, the conditions were met for Assets held for sale treatment in our Consolidated Financial Statements for the assets to be contributed to the new company. Upon movement of the assets to be contributed, which consisted primarily of fixed and intangible assets to Assets held for sale , the relevant depreciation and amortization charges were stopped under Statement of Financial Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( FAS 144 ). Furthermore, FAS 144 requires an impairment analysis when assets are moved to Assets held for sale based on the difference between the Net Book Value and the Fair Value, less costs to sell, of the group of assets (and liabilities) to be sold. As a result of this review, we have registered a pre-tax loss in 2007 of $1,106 million, an additional pre-tax $1 million impairment charge on certain specific equipment that could not be transferred and for which no alternative future use could be found in the Company (as disclosed above in the paragraph related to property, plant and equipment) and an additional pre-tax $5 million of other related disposal costs. Fair value less costs to sell was based on the net consideration of the agreement and significant estimates about the valuation of our associated equity ownership. The final amount could be different subject to adjustments due to business evolution before closing of the transaction.

*Restructuring charges.* We have undertaken, and we may continue to undertake, significant restructuring initiatives, which have required us, or may require us in the future, to develop formalized plans for exiting any of our existing activities. We recognize the fair value of a liability for costs associated with exiting an activity when a probable liability exists and it can be reasonably estimated. We record estimated charges for non-voluntary termination benefit arrangements such as severance and outplacement costs meeting the criteria for a liability as described above. Given the significance of and the timing of the execution of such activities, the process is complex and involves periodic reviews of estimates made at the time the original decisions were taken. As we operate in a highly cyclical industry, we monitor and evaluate business conditions on a regular basis. If broader or newer initiatives, which could include production curtailment or closure of other manufacturing facilities, were to be taken, we may be required to incur additional charges as well as to change estimates of amounts previously recorded. The potential impact of these changes could be material and could

have a material adverse effect on our results of operations or financial condition. In 2007, the net amount of restructuring charges and other related closure costs amounted to $105 million before taxes (including the $5 million related to the FMG deconsolidation as mentioned above). As of December 31, 2007, we had incurred $62 million of restructuring charges (excluding any impairment charges that are mentioned above) of the total expected approximate $270 million to $300 million in pre-tax charges associated with the new 2007 manufacturing restructuring plan of our manufacturing activities. The plan was defined on July 10, 2007 and is expected to take two to three years to complete. See Note 21 to our Unaudited Interim Consolidated Financial Statements.

*Share-based compensation.* We are required to expense our employees share-based compensation awards for financial reporting purposes. We measure our share-based compensation cost based on the fair value on

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the grant date of each award. This cost is recognized over the period during which an employee is required to provide service in exchange for the award or the requisite service period, usually the vesting period, and is adjusted for actual forfeitures that occur before vesting. Our share-based compensation plans may award shares contingent on the achievement of certain financial objectives, including market performance and financial results. In order to assess the fair value of this share-based compensation, we are required to estimate certain items, including the probability of meeting the market performance and financial results targets, the forfeitures and the service period of our employees. As a result, in 2007 we recorded a total pre-tax expense of $73 million out of which $9 million are related to the 2005 Unvested Stock Award Plan, $44 million to the 2006 Unvested Stock Award Plan and $20 million to the 2007 Unvested Stock Award Plan.

*Income taxes.* We are required to make estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments also occur in the calculation of certain tax assets and liabilities and provisions. Furthermore, the adoption of the Financial Accounting Standards Board ( FASB ) interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 ( FIN 48 ) requires an evaluation of the probability of any tax uncertainties and the booking of the relevant charges.

We are also required to assess the likelihood of recovery of our deferred tax assets. If recovery is not likely, we are required to record a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable, which would increase our provision for income taxes. As of December 31, 2007, we believed that all of the deferred tax assets, net of valuation allowances, as recorded on our consolidated balance sheet, would ultimately be recovered. However, should there be a change in our ability to recover our deferred tax assets (in our estimates of the valuation allowance) or a change in the tax rates applicable in the various jurisdictions, this could have an impact on our future tax provision in the periods in which these changes could occur.

*Patent and other intellectual property litigation or claims.* As is the case with many companies in the semiconductor industry, we have from time to time received, and may in the future receive, communications alleging possible infringement of patents and other intellectual property rights of others. Furthermore, we may become involved in costly litigation brought against us regarding patents, mask works, copyrights, trademarks or trade secrets. In the event that the outcome of any litigation would be unfavorable to us, we may be required to take a license to the underlying intellectual property right upon economically unfavorable terms and conditions, and possibly pay damages for prior use, and/or face an injunction, all of which singly or in the aggregate could have a material adverse effect on our results of operations and ability to compete. See Item 3. Key Information Risk Factors Risks Related to Our Operations We depend on patents to protect our rights to our technology.

We record a provision when we believe that it is probable that a liability has been incurred and when the amount of the loss can be reasonably estimated. We regularly evaluate losses and claims with the support of our outside counsel to determine whether they need to be adjusted based on the current information available to us. Legal costs associated with claims are expensed as incurred. In the event of litigation that is adversely determined with respect to our interests, or in the event that we need to change our evaluation of a potential third-party claim based on new evidence or communications, this could have a material adverse effect on our results of operations or financial condition at the time it were to materialize. We are in discussion with several parties with respect to claims against us relating to possible infringements of patents and similar intellectual property rights of others.

As of December 31, 2007, based on our assessment, we did not record any provisions in our financial statements relating to legal proceedings, because we had not identified any risk of probable loss that is likely to arise out of the proceedings. There can be no assurance, however, that we will be successful in resolving these proceedings. If we are unsuccessful, or if the outcome of any litigation or claim were to be unfavorable to us, we may incur monetary

damages, or an injunction. Furthermore, our products as well as the products of our customers which incorporate our products may be excluded from entry into U.S. territory pursuant to an exclusion order.

*Pension and Post Retirement Benefits.* Our results of operations and our consolidated balance sheet include the impact of pension and post retirement benefits that are measured using actuarial valuations. At December 31, 2007, our pension obligations amounted to $323 million based on the assumption that our employees will work with us until they reach the age of retirement. These valuations are based on key assumptions, including discount rates, expected long-term rates of return on funds and salary increase rates. These assumptions are updated on an annual basis at the beginning of each fiscal year or more frequently

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upon the occurrence of significant events. Any changes in the pension schemes or in the above assumptions can have an impact on our valuations.

*Other claims.* We are subject to the possibility of loss contingencies arising in the ordinary course of business. These include, but are not limited to: warranty costs on our products not covered by insurance, breach of contract claims, tax claims and provisions for specifically identified income tax exposures as well as claims for environmental damages. In determining loss contingencies, we consider the likelihood of a loss of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of such loss or liability. An estimated loss is recorded when we believe that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We regularly reevaluate any losses and claims and determine whether our provisions need to be adjusted based on the current information available to us. In the event we are unable to estimate in a correct and timely manner the amount of such loss this could have a material adverse effect on our results of operations or financial condition at the time such loss were to materialize.

***Fiscal Year 2007***

Under Article 35 of our Articles of Association, our financial year extends from January 1 to December 31, which is the period end of each fiscal year. Our fiscal year starts on January 1 and the first quarter of 2007 ended on March 31, 2007. The second quarter of 2007 ended on June 30, 2007, and the third quarter of 2007 ended on September 29, 2007. The fourth quarter ended on December 31, 2007. Based on our fiscal calendar, the distribution of our revenues and expenses by quarter may be unbalanced due to a different number of days in the various quarters of the fiscal year.

***2007 Business Overview***

In 2007, the semiconductor market was characterized by a solid increasing demand in units, supported by a strong economic environment, but with a significant decline in average selling prices, particularly in memory products. As a result, the 2007 growth rate for the semiconductor industry was lower than the 2006 growth rate.

The total available market is defined as the TAM , while the serviceable available market, the SAM , is defined as the market for products produced by us (which consists of the TAM and excludes PC motherboard major devices such as microprocessors ( MPU ), dynamic random access memories ( DRAM ), and optoelectronics devices).

Based upon recently published data by the World Semiconductor Trade Statistics ( WSTS ), semiconductor industry revenues increased year-over-year by approximately 3% for the TAM and 6% for the SAM in 2007 to reach approximately $256 billion and approximately $174 billion, respectively. This increase was driven by a robust demand in units while average selling prices declined compared to 2006.

Our 2007 revenues were characterized by a significantly high volume demand and improved products mix, which did not translate into an equivalent revenue performance due to the persisting negative impact of price pressure in the markets we serve. As a result, our revenues increased by approximately 2% to $10,001 million compared to $9,854 million in 2006. Strong growth in revenues was driven by a double-digit increase in digital consumer application and a mid-single contribution of Automotive application, while FMG revenues registered a double-digit revenues decrease. Our 2007 sales performance was below both the TAM and the SAM growth rates. Excluding Flash segment, our revenues increased about 4.3%. This performance was above the TAM without Flash, which increased about 2.6% but below the SAM without Flash, which increased by 5.1%.

With reference to the quarterly results, our fourth quarter 2007 revenues performance was above the TAM and the SAM on a sequential basis. On a year-over-year basis, our performance was above the TAM but below the SAM.

On a year-over-year basis, our fourth quarter 2007 revenues increased by approximately 10% to $2,742 million compared to $2,483 million in the fourth quarter of 2006, due largely to the ASG segment, which grew by approximately 13%, driven primarily by imaging products, data storage and application-specific wireless, and IMS revenues which improved by approximately 11% reflecting strength in MEMS and in advanced analog products. The revenues of the FMG segment continued to register a decline. On a year-over-year basis, the TAM and the SAM registered increases of approximately 3% and 12% respectively.

On a sequential basis, in the fourth quarter of 2007 revenues increased approximately 7% mainly due to the overall strength in the Telecom sector. Our net revenues performance was slightly above the mid-range of our guidance, which indicated a sequential growth between 4% and 9%. Sequentially, the TAM registered a decrease of approximately 1% while the SAM remained flat.

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In 2007, our effective average U.S. dollar exchange rate was 1.00 for $1.35, which reflects the actual exchange rate levels and the impact of certain hedging contracts, compared to our 2006 effective average exchange rate of 1.00 for $1.24. For a more detailed discussion of our hedging arrangements and the impact of fluctuations in exchange rates, see Impact of Changes in Exchange Rates below.

On a total year basis, our gross margin decreased from 35.8% in 2006 to 35.4% in 2007 due to the negative impact of declining selling prices and the weakening of the U.S. dollar, which offset the improvements coming from better manufacturing performance and improved products mix. In 2007, our gross margin also benefited from the suspended depreciation on our assets that were part of the FMG disposal and were classified as held for sale following the announcement of the transaction on May 22, 2007.

On a sequential basis, our gross margin increased from 35.2% to 36.9% in the fourth quarter 2007, due to improved manufacturing efficiency which also included the suspended depreciation on the FMG assets held for sale. Our fourth quarter gross margin was above the midpoint of our guidance that had indicated a gross margin of approximately 36.5% plus or minus one percentage point.

Our operating expenses combining selling, general and administrative expenses and research and development increased in 2007 compared to 2006 due to the unfavorable U.S. dollar impact, the higher spending in research and development and higher share-based compensation charges for our employees and members and professionals of the Supervisory Board.

Our total impairment and restructuring charges for 2007 were significantly higher compared to 2006 due to the impairment charge for the planned disposal of the FMG assets held for sale and for the new manufacturing restructuring plan launched in 2007.

In 2007, we benefited from a significant increase in funding for our research and development activities, which contributed to move Other income and expenses, net caption in our consolidated statements of income from a net expense of $35 million in 2006 to a net income of $48 million.

The combined effect of the above mentioned factors and the other operating items resulted in a negative impact on our operating income, mainly related to the impairment charge and other related closure costs of the planned disposal of the FMG assets held for sale; excluding the impairment and restructuring charges, our operating income registered a decrease in 2007 over 2006 mainly due to the weakening of the U.S. dollar and declining prices, which offset the benefit of the higher sales volume and of the improved products mix. On a quarterly basis, however, the fourth quarter 2007 operating income registered solid improvement both on a year-over-year and a sequential basis when excluding the impact of impairment and restructuring charges.

In summary, our financial results for 2007 compared to the results of 2006 were favorably impacted by the following factors:

- continuous improvement of our manufacturing performances;
- the suspension of depreciation on the FMG assets held for sale;
- higher sales volume and a more favorable products mix; and
- benefit of increased funding to our research and development activities.

Our financial results in 2007 were negatively affected by the following factors:

the provision for the upcoming disposal of the FMG assets held for sale and other impairment and restructuring charges;

the weakening of the U.S. dollar exchange rate; and

negative pricing trends.

In 2007, we continued to invest in upgrading and expanding our manufacturing capacity but at a reduced capital expenditures to sales ratio. Total capital expenditures in 2007 were $1,140 million, which were financed entirely by net cash generated from operating activities. In fact, we generated $840 million of net operating cash flow during the year. Net operating cash flow is not a U.S. GAAP measure, as further discussed in the section Liquidity and Capital Resources Liquidity Net operating cash flow. At December 31, 2007, we had cash, cash equivalents, m