

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2001.

OR

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

For the transition period from _____ to _____.

Commission File Number: 0-21184

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

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

86-0629024
(I.R.S. Employer
Identification No.)

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

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

Yes ☒ No ☐

Number of shares of common stock, \$.001 Par Value, outstanding as of
FEBRUARY 1, 2002: 132,991,677 shares.

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share amounts)

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ASSETS

	December 31, 2001	March 31, 2001
	(Unaudited) <C>	(Note 1) <C>
Cash and cash equivalents	\$ 245,395	\$ 129,909
Accounts receivable, net	64,500	76,543
Inventories	92,256	95,699
Prepaid expenses	4,875	19,072
Deferred tax asset	37,164	47,508
Other current assets	34,439	2,828
Total current assets	478,629	371,559
Property, plant and equipment, net	733,409	780,016
Other assets	8,509	9,774
Total assets	\$1,220,547	\$1,161,349

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term lines of credit	\$ 2,138	\$ --
Accounts payable	31,293	57,652
Accrued liabilities	51,589	72,865
Deferred income on shipments to distributors	41,179	64,106
Total current liabilities	126,199	194,623
Pension accrual	758	912
Deferred tax liability	29,725	22,966
Stockholders' equity:		
Preferred stock, \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding	--	--
Common stock, \$.001 par value; authorized 300,000,000 shares; issued and outstanding 133,866,075 shares at December 31, 2001; issued and outstanding 130,897,639 shares at March 31, 2001;	134	131
Additional paid-in capital	470,813	418,277
Retained earnings	592,918	524,440
Total stockholders' equity	1,063,865	942,848
Total liabilities and stockholders' equity	\$1,220,547	\$1,161,349

</TABLE>

See accompanying notes to condensed consolidated financial statements

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)
(Unaudited)

<TABLE>
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	Three Months Ended December 31,		Nine Months Ended December 31,	
	2001	2000	2001	2000
<S>	<C>	<C>	<C>	<C>
Net sales	\$ 141,857	\$ 190,134	\$ 422,413	\$ 562,364
Cost of sales	70,718	88,512	210,999	258,214
Gross profit	71,139	101,622	211,414	304,150
Operating expenses:				
Research and development	21,409	21,143	61,111	58,091
Selling, general and administrative	19,869	26,220	61,477	79,482

	41,278	47,363	122,588	137,573
Operating income	29,861	54,259	88,826	166,577
Other income (expense):				
Gain on sale of investment	--	--	--	1,427
Net loss in equity investment	--	(213)	--	(626)
Interest income	1,187	3,306	3,733	11,108
Interest expense	(111)	(166)	(443)	(481)
Other, net	86	1,117	449	1,452
	-----	-----	-----	-----
Income before income taxes	31,023	58,303	92,565	179,457
Income taxes	7,446	16,056	24,067	48,843
	-----	-----	-----	-----
Net income	\$ 23,577	\$ 42,247	\$ 68,498	\$ 130,614
	=====	=====	=====	=====
Basic net income per share	\$ 0.18	\$ 0.33	\$ 0.52	\$ 1.02
	=====	=====	=====	=====
Diluted net income per share	\$ 0.17	\$ 0.31	\$ 0.49	\$ 0.96
	=====	=====	=====	=====
Weighted average common shares outstanding	133,515	129,364	132,587	128,052
	=====	=====	=====	=====
Weighted average common and potential common shares outstanding	139,873	136,551	138,749	136,265
	=====	=====	=====	=====

</TABLE>

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

	Nine Months Ended December 31,	
	2001	2000
	-----	-----
Cash flows from operating activities:		
Net income	\$ 68,498	\$ 130,614
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	43	885
Provision for inventory valuation	4,735	6,265
Provision for pension accrual	87	135
Gain on sale of fixed assets	(240)	(931)
Gain on sale of investment	--	(1,427)
Net loss in equity investment	--	626
Depreciation and amortization	82,075	75,185
Amortization of purchased technology	513	2,041
Deferred income taxes	17,103	(4,482)
Tax benefit from exercise of stock options	15,488	14,392
(Increase) decrease in accounts receivable	12,000	(2,225)
Increase in inventories	(1,292)	(25,289)
Increase (decrease) in accounts payable and accrued liabilities	(47,655)	80,080
Change in other assets and liabilities	(39,830)	6,911
	-----	-----
Net cash provided by operating activities	111,525	282,780
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(36,257)	(405,927)
Acquisition of common stock of MEAD Microelectronics, net of cash acquired	--	(1,330)
Proceeds from sale of assets	1,029	1,778
	-----	-----
Net cash used in investing activities	(35,228)	(405,479)
	-----	-----
Cash flows from financing activities:		
Proceeds from (repayment on) lines of credit	2,138	(9,000)
Proceeds from sale of stock and put options	37,051	31,019
	-----	-----
Net cash provided by financing activities	39,189	22,019
	-----	-----
Net increase (decrease) in cash and cash equivalents	115,486	(100,680)

Cash and cash equivalents at beginning of period	129,909	294,407
	-----	-----
Cash and cash equivalents at end of period	\$ 245,395	\$ 193,727
	=====	=====
Supplemental disclosure of non-cash financing and investing activities:		
Net share settlement delivery of shares	\$ 10,117	\$ 12,848
Net share settlement receipt of shares	\$ --	\$ 6,610

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001
(UNAUDITED)

(1) BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, all adjustments of a normal recurring nature which are necessary for a fair presentation have been included. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such Securities and Exchange Commission rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2001. The results of operations for the three and nine months ended December 31, 2001 are not necessarily indicative of the results that may be expected for the year ended March 31, 2002.

On January 16, 2001, we merged with TelCom Semiconductor, Inc. The merger has been accounted for as a pooling of interests. Accordingly, the condensed consolidated financial statements have been restated to include the operations of TelCom for all periods presented.

(2) ACCOUNTS RECEIVABLE

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

	December 31, 2001	March 31, 2001
	-----	-----
Trade accounts receivable	\$ 68,386	\$ 79,966
Other	345	768
	-----	-----
	68,731	80,734
Less allowance for doubtful accounts	4,231	4,191
	-----	-----
	\$ 64,500	\$ 76,543
	=====	=====

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(3) INVENTORIES

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

	December 31, 2001	March 31, 2001
	-----	-----
Raw materials	\$ 6,972	\$ 9,945
Work in process	61,814	51,197
Finished goods	23,470	34,557
	-----	-----
	\$ 92,256	\$ 95,699
	=====	=====

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

(4) PROPERTY, PLANT AND EQUIPMENT

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

	December 31, 2001	March 31, 2001
	-----	-----
Land	\$ 23,685	\$ 23,685
Building and building improvements	184,876	167,297
Machinery and equipment	723,265	688,096
Projects in process	207,292	225,172
	-----	-----
	1,139,118	1,104,250
Less accumulated depreciation and amortization	405,709	324,234
	-----	-----
	\$ 733,409	\$ 780,016
	=====	=====

Certain reclassifications have been made to the March 31, 2001 amounts to properly reflect the portion of the Company's property in Puyallup, Washington that has not been placed in service. This reclassification had no effect on the Company's results of operations.

Depreciation and amortization expense attributed to property and equipment was \$82.1 million and \$75.2 million for the nine months ended December 31, 2001 and December 31, 2000, respectively.

(5) LINES OF CREDIT

The Company has an unsecured revolving credit facility with a syndicate of banks totaling \$100,000,000, bearing interest at LIBOR plus 0.625%. The Company can elect to increase the facility to \$150,000,000, subject to certain conditions set forth in the credit agreement. This facility has a termination date of May 31, 2003. The Company had no borrowings against this line of credit as of December 31, 2001. The credit facility requires the Company to achieve certain financial ratios and achieve operating results to maintain the credit facility. The Company's ability to fully utilize this credit facility is dependent on it being in compliance with such covenants and ratios. The Company was in compliance with these covenants as of December 31, 2001.

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The Company has an additional unsecured line of credit with various financial institutions in Asia for up to \$24,600,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in U.S. Dollars, bearing interest at the Singapore Interbank Offering Rate (SIBOR) of 2.45% at December 31, 2001 plus 0.5% (average) and expiring on various dates through September 2002. There were borrowings of \$2,137,500 against this line of credit as of December 31, 2001, and an allocation of \$894,000 of the available line was made, relating to import guarantees associated with the Company's business in Thailand. There are no covenants relative to the foreign line of credit.

(6) STOCKHOLDERS' EQUITY

The Company had outstanding a net shares settled forward contract as of December 31, 2001. In connection with this contract, the Company made a net delivery of 381,763 shares of its common stock during the nine months ended December 31, 2001, and a net delivery of 478,781 shares of its common stock during the nine months ended December 31, 2000. The Company also received \$14,083,638 in connection with an early termination covering 1,100,000 of the shares outstanding in the net shares settled forward contract during the quarter ended December 31, 2001. At December 31, 2001, 1,073,737 shares remained outstanding under the contract. The Company closed out the net shares settled forward contract in its entirety on January 15, 2002 by making a cash payment of \$27,776,610. The purchased shares are held as treasury shares and are being used to fund stock option exercises and purchases under the Company's employee stock purchase plan.

(7) NET INCOME PER SHARE

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

<TABLE>
<CAPTION>

	Three Months Ended		Nine Months Ended	
	-----		-----	
	December 31,	December 31,	December 31,	December 31,
	2001	2000	2001	2000
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Net income	\$ 23,577	\$ 42,247	\$ 68,498	\$130,614

Weighted average common

shares outstanding	133,515	129,364	132,587	128,052
Dilutive effect of stock options	6,358	7,187	6,162	8,213
	-----	-----	-----	-----
Weighted average common and potential common shares outstanding	139,873	136,551	138,749	136,265
	=====	=====	=====	=====
Basic net income per share	\$ 0.18	\$ 0.33	\$ 0.52	\$ 1.02
	=====	=====	=====	=====
Diluted net income per share	\$ 0.17	\$ 0.31	\$ 0.49	\$ 0.96
	=====	=====	=====	=====

</TABLE>

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

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

	Three Months Ended December 31, (Unaudited)		Nine Months Ended December 31, (Unaudited)	
	2001	2000	2001	2000
	-----	-----	-----	-----
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	49.9%	46.6%	50.0%	45.9%
	-----	-----	-----	-----
Gross profit	50.1%	53.4%	50.0%	54.1%
Research and development	15.1%	11.1%	14.5%	10.4%
Selling, general and administrative	14.0%	13.8%	14.5%	14.1%
	-----	-----	-----	-----
Operating income	21.0%	28.5%	21.0%	29.6%
	=====	=====	=====	=====

NET SALES

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

Our net sales for the quarter ended December 31, 2001 were \$141.9 million, approximately equal to the previous quarter's sales of \$141.7 million, and a decrease of 25.4% from net sales of \$190.1 million in the quarter ended December 31, 2000. Our net sales for the nine months ended December 31, 2001 were \$422.4 million, a decrease of 24.9% from our net sales of \$562.3 million for the nine months ended December 31, 2000. The decrease in net sales for the three and nine month periods ended December 31, 2001, as compared to the three and nine month periods ended December 31, 2000, is the result of inventory corrections at our customers, slowing demand from end markets and overall semiconductor industry conditions.

Net sales of our microcontroller products increased approximately 2% in the three months ended December 31, 2001, as compared to the three months ended September 30, 2001. The growth in net sales of our microcontroller products is attributed to our continuing design win performance and the overall positioning of our proprietary product offerings. Net sales of our Serial EEPROM memory products increased approximately 3% in the three months ended December 31, 2001, as compared to the three months ended September 30, 2001 as pricing declines of approximately 4% were offset by growth in unit volumes and changes in product mix. Net sales of our analog and interface products decreased approximately 18% in the three months ended December 31, 2001 as compared to the three months ended September 30, 2001. The decrease in net sales of our analog and interface products can be attributed to decreased demand, primarily in the telecommunications market.

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Sales by product line for the three and nine months ended December 31, 2001 and 2000 were as follows (in thousands):

<TABLE>
<CAPTION>

	Three Months Ended December 31, (Unaudited)	Nine Months Ended December 31, (Unaudited)
	-----	-----

	2001	%	2000	%	2001	%	2000	%
	-----	-----	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Microcontrollers	\$111,428	78.5%	\$119,550	62.9%	\$328,719	77.8%	\$356,242	63.3%
Serial EEPROM memories	\$ 20,681	14.6%	\$ 54,725	28.8%	\$ 61,888	14.7%	\$148,848	26.5%
Analog and interface products	\$ 9,748	6.9%	\$ 15,589	8.3%	\$ 31,806	7.5%	\$ 57,274	10.2%
	-----	-----	-----	-----	-----	-----	-----	-----
Total sales	\$141,857	100.0%	\$190,134	100.0%	\$422,413	100.0%	\$562,364	100.0%
	=====	=====	=====	=====	=====	=====	=====	=====

</TABLE>

Our net sales in any given quarter depend upon a combination of shipments from backlog and orders received in that quarter for shipment in that quarter, which we refer to as turns orders. We measure turns orders at the beginning of a quarter based on the orders needed to meet the revenue target that we set entering the quarter. We have emphasized our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with short delivery schedules. Turns orders directly correlate to product lead times, which are currently between two and four weeks generally, as compared to four to 12 weeks generally a year ago. Shorter lead times have the effect of increasing turns orders as a percentage of our business in any given quarter and reducing our visibility on future product shipments. With current lead times between two and four weeks, customers do not place orders beyond their immediate requirements and therefore, we do not currently have the order visibility we experienced throughout fiscal 2001. The percentage of turns orders in any given quarter is dependent on overall semiconductor industry conditions and product lead times. As such, our percentage of turns orders has fluctuated over the last three fiscal years between 20% and 65%. At January 1, 2002, we required turns orders of approximately 61% in order to achieve our revenue target for the fourth quarter of fiscal 2002. At October 1, 2001, we required turns orders of approximately 51% to achieve our revenue target for the third quarter of fiscal 2002.

Turns orders are difficult to predict, and we may not experience the combination of turns orders and shipments from backlog in any quarter that would be sufficient to achieve anticipated net sales. If we do not achieve a sufficient level of turns orders in a particular quarter, our net sales and operating results will suffer.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller products have remained relatively constant, while average selling prices of our memory products have declined over time. During the fiscal year ended March 31, 2001, we initially experienced price increases in our Serial EEPROM products, but in the fourth quarter of fiscal 2001 we began experiencing pricing and competitive pressures which resulted in price reductions averaging approximately 10% as compared to the third quarter of fiscal 2001. We experienced significant competitive pressures for our Serial EEPROM products in the first half of fiscal 2002. In the third quarter of fiscal 2002 pricing of Serial EEPROM products declined by approximately 4%, demonstrating that the Serial EEPROM market is stabilizing with easing pricing pressure and growth in unit volume. We expect pricing of our Serial EEPROM products to decline in the fourth quarter of fiscal 2002 by approximately the same percentage as the decline in the third quarter of fiscal 2002.

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We have experienced, and expect to continue to experience, moderate pricing pressure in certain microcontroller product lines, due primarily to competitive conditions. We have been able to maintain average selling prices for microcontroller products by introducing new products with more features and higher prices, thereby offsetting price declines in older products.

We may be unable to maintain average selling prices for our microcontroller or other products as a result of increased pricing pressure in the future, which would reduce our operating results.

THE FOREGOING STATEMENTS REGARDING THE LEVEL OF TURNS ORDERS REQUIRED TO MEET OUR REVENUE TARGET FOR THE FOURTH QUARTER OF FISCAL 2002, AVERAGE SELLING PRICES, STABILIZATION OF THE PRICING ENVIRONMENT FOR SERIAL EEPROM PRODUCTS, PRICING DECLINES IN SERIAL EEPROM PRODUCTS IN THE FOURTH QUARTER OF FISCAL 2002, AND PRICING PRESSURES IN CERTAIN MICROCONTROLLER PRODUCT LINES ARE FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: THE LEVEL OF ORDERS THAT ARE RECEIVED AND CAN BE SHIPPED IN A QUARTER; DEMAND FOR OUR PRODUCTS; INVENTORY MIX AND TIMING OF CUSTOMER ORDERS; CUSTOMERS' INVENTORY LEVELS, ORDER PATTERNS AND SEASONALITY; COMPETITION AND COMPETITIVE PRESSURES ON PRICING AND PRODUCT AVAILABILITY; POSSIBLE DISRUPTION IN COMMERCIAL ACTIVITIES OCCASIONED BY TERRORIST ACTIVITY AND ARMED CONFLICT, SUCH AS CHANGES IN LOGISTICS AND SECURITY ARRANGEMENTS, AND REDUCED END-USER PURCHASES RELATIVE TO EXPECTATIONS; IMPACT OF EVENTS OUTSIDE THE UNITED STATES, SUCH AS THE BUSINESS IMPACT OF FLUCTUATING CURRENCY RATES OR

UNREST OR POLITICAL INSTABILITY; THE CYCLICAL NATURE OF BOTH THE SEMICONDUCTOR INDUSTRY AND THE MARKETS ADDRESSED BY OUR PRODUCTS; MARKET ACCEPTANCE OF OUR NEW PRODUCTS AND THOSE OF OUR CUSTOMERS; FLUCTUATIONS IN PRODUCTION YIELDS, PRODUCTION EFFICIENCIES AND OVERALL CAPACITY UTILIZATION; CHANGES IN PRODUCT MIX; AND ABSORPTION OF FIXED COSTS, LABOR AND OTHER FIXED MANUFACTURING COSTS.

Distributors accounted for approximately 60% of our net sales in each of the three month periods ending December 31, 2001 and December 31, 2000. Distributors accounted for approximately 61% of our net sales in the nine months ended September 30, 2001, and approximately 63% of our net sales in the nine months ended December 31, 2000. Our largest distributor accounted for approximately 12% of our total net sales for the three and nine months ended December 31, 2001. Our largest distributor accounted for approximately 13% of our total net sales for the three months ended December 31, 2000, and 14% of our total net sales for the nine months ended December 31, 2000. Generally, we do not have long-term agreements with our distributors and our distributors may terminate their relationships with us with little or no advanced notice. The loss of, or the disruption in the operations of, one or more of our distributors could reduce our future net sales in a given quarter and could result in an increase in inventory returns.

Sales by geography for the three and nine months ended December 31, 2001 and 2000 were as follows (in thousands):

<TABLE>
<CAPTION>

	Three Months Ended December 31, (Unaudited)				Nine Months Ended December 31, (Unaudited)			
	2001	%	2000	%	2001	%	2000	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Americas	\$ 47,467	33.5%	\$ 65,168	34.3%	\$143,937	34.1%	\$185,530	33.0%
Europe	43,188	30.4%	55,092	29.0%	132,799	31.4%	163,843	29.1%
Asia	51,202	36.1%	69,874	36.7%	145,677	34.5%	212,991	37.9%
	-----	-----	-----	-----	-----	-----	-----	-----
Total Sales	\$141,857	100.0%	\$190,134	100.0%	\$422,413	100.0%	\$562,364	100.0%
	=====	=====	=====	=====	=====	=====	=====	=====

</TABLE>

Our sales to foreign customers have been predominately in Asia and Europe, which we attribute to the manufacturing strength in those areas for automotive, communications, computing, consumer and industrial control products. Americas

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sales include sales to customers in the United States, Canada, Central America and South America. Sales to foreign customers accounted for approximately 69% of our net sales in the three months ended December 31, 2001 and approximately 66% of our net sales in the three months ended December 31, 2000. Sales to foreign customers accounted for approximately 69% of our net sales in the nine month periods ending December 31, 2001, and approximately 68% of our net sales in the nine months ended December 31, 2000. The majority of our foreign sales are U.S. Dollar denominated.

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

GROSS PROFIT

Our gross profit was \$71.1 million in the three months ended December 31, 2001, and \$101.6 million in the three months ended December 31, 2000. Our gross profit was \$211.4 million in the nine months ended December 31, 2001 and \$304.2 million in the nine months ended December 31, 2000. Gross profit as a percent of sales was 50.1% in the three months ended December 31, 2001, and 53.4% in the three months ended December 31, 2000. Gross profit as a percent of sales was 50.0% in the nine months ended December 31, 2001, and 54.1% in the nine months ended December 31, 2000.

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

- * reduced levels of manufacturing capacity utilization in the first three quarters of fiscal 2002
- * continued cost reductions in wafer fabrication and assembly and test manufacturing in all periods covered by this report
- * the ability to maintain average selling prices for our microcontroller products where moderate pricing pressures have been offset by new product introductions with more features and higher selling prices

- * significant competitive pricing pressures in Serial EEPROM memory products in the first half of fiscal 2002 returning to a more normal pricing environment in the December 2001 quarter
- * fluctuations in the product mix of proprietary microcontroller and analog products and related commodity memory products as illustrated in the chart in Net Sales on page 10, and
- * cost reductions associated with one-week plant shutdowns in each of the first three quarters of fiscal 2002.

As of March 31, 2001, we had reduced cumulative wafer capacity at our wafer fabs by approximately 24% in response to business conditions that resulted in decreased product demand. During the first three quarters of fiscal 2002 our wafer fabs operated at approximately 70% of their capacity due to the capacity reductions implemented in the March 2001 quarter and a one-week plant shutdown in each of the first three quarters of fiscal 2002. Overall inventory levels have declined from \$95.7 million as of March 31, 2001 to \$92.2 million as of December 31, 2001, confirming that capacity has been reduced to a level more aligned with market demand for the nine month period ended December 31, 2001. Beginning with the March 2001 quarter, our overall gross margins have been negatively impacted by these actions due to the relatively high fixed costs inherent in our wafer fabrication manufacturing, which continue even at lower capacity levels.

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The start-up date of our Puyallup, Washington semiconductor manufacturing complex has been delayed until October 2003, subject to business conditions and capacity requirements. We will need to begin facilitization work at the site approximately 12 months prior to the expected start-up date. We currently intend to maintain the Puyallup facility at a minimum cost basis until it is required for capacity expansion.

We continue to transition products to our 0.7-micron and 0.5-micron process technologies to reduce future manufacturing costs. In the three and nine months ended December 31, 2001, approximately 80% of our production was on 8-inch wafers. In fiscal 2001, products produced on 8-inch wafers increased from approximately 55% at the beginning of fiscal 2001 to approximately 80% at the end of fiscal 2001. We anticipate that gross margins will fluctuate over time, driven primarily by the product mix of microcontroller products and related memory products, manufacturing yields, fixed cost absorption, wafer fab loading levels and competitive and economic conditions.

THE FOREGOING STATEMENTS RELATING TO OUR BELIEF THAT OUR CAPACITY REDUCTION ACTIONS HAVE ALIGNED CAPACITY WITH MARKET DEMAND, THE ANTICIPATED START-UP DATE OF THE PUYALLUP FACILITY AND THE LEAD TIME NECESSARY TO FACILITATE THE PUYALLUP FACILITY, OUR INTENTION TO OPERATE THE PUYALLUP FACILITY AT A MINIMUM COST BASIS, THE TRANSITION TO HIGHER YIELDING MANUFACTURING PROCESSES TO REDUCE FUTURE OPERATING COSTS AND THE FLUCTUATION OF GROSS MARGINS OVER TIME ARE FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: DEMAND FOR OUR PRODUCTS; FLUCTUATIONS IN PRODUCTION YIELDS, PRODUCTION EFFICIENCIES AND OVERALL CAPACITY UTILIZATION; ABSORPTION OF FIXED COSTS, LABOR AND OTHER DIRECT MANUFACTURING COSTS; COMPETITION AND COMPETITIVE PRESSURE ON PRICING; POSSIBLE DISRUPTION IN COMMERCIAL ACTIVITIES OCCASIONED BY TERRORIST ACTIVITY AND ARMED CONFLICT, SUCH AS CHANGES IN LOGISTICS AND SECURITY ARRANGEMENTS, AND REDUCED END-USER PURCHASES RELATIVE TO EXPECTATIONS; IMPACT OF EVENTS OUTSIDE THE UNITED STATES, SUCH AS THE BUSINESS IMPACT OF FLUCTUATING CURRENCY RATES OR UNREST OR POLITICAL INSTABILITY; THE ABILITY TO INCREASE MANUFACTURING CAPACITY AS NEEDED; COST AND AVAILABILITY OF RAW MATERIALS; CHANGES IN PRODUCT MIX; AND OTHER INDUSTRY AND ECONOMIC CONDITIONS.

Currently, approximately half of our assembly operations are performed by third-party contractors located throughout Asia. The balance of our assembly operations is performed at our Thailand facility. As of December 31, 2001, approximately 50% of our assembly requirements were being performed in our Thailand facility, as compared to approximately 33% as of December 31, 2000. Substantially all of our test requirements were being performed in our Thailand facility as of December 31, 2001, as compared to approximately 81% as of December 31, 2000. We believe that the assembly and test operations performed at our Thailand facility provide us with significant cost savings when compared to third-party contractor assembly and test costs, as well as increased control of these portions of the manufacturing process.

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

Our reliance on foreign operations, maintenance of substantially all of our finished goods in inventory at foreign locations, and significant foreign sales exposes us to foreign political and economic risks, including:

- * political, social and economic instability
- * trade restrictions and changes in tariffs

- * import and export license requirements and restrictions
- * difficulties in staffing and managing international operations
- * disruptions in international transport or delivery
- * fluctuations in currency exchange rates
- * difficulties in collecting receivables
- * economic slowdown in the worldwide markets served by us, and
- * potentially adverse tax consequences.

To date, we have not experienced any significant interruptions in our foreign business operations. If any of these risks materialize, our sales could decrease and our operations performance could suffer.

RESEARCH AND DEVELOPMENT

Research and development expenses for the three months ended December 31, 2001 were \$21.4 million, or 15.1% of sales, compared to \$21.1 million, or 11.1% of sales for the three months ended December 31, 2000. Research and development expenses for the nine months ended December 31, 2001 were \$61.1 million, or 14.5% of sales, compared to \$58.1 million, or 10.4% of sales for the nine months ended December 31, 2000. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. We expense all research and development costs as incurred. Research and development expenses include expenditures for labor, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

Research and development expenses increased \$0.3 million, or 1.3% for the three months ended December 31, 2001 over the same period last year. Research and development expenses increased \$3.0 million, or 5.2% for the nine months ended December 31, 2001 over the same period last year. Research and development expenses increased \$1.2 million, or 6.2% for the three months ended December 31, 2001 over the three months ended September 30, 2001. The primary reason for the dollar increase in research and development costs in each of these periods was increased labor and professional service costs associated with expanding our technical resources.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses for the three months ended December 31, 2001 were \$19.9 million, or 14.0% of sales, compared to \$26.2 million, or 13.8% of sales for the three months ended December 31, 2000. Selling, general and administrative expenses for the nine months ended December 31, 2001 were \$61.5 million, or 14.5% of sales, compared to \$79.5 million, or 14.1% of sales in the nine months ended December 31, 2000. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force and field applications engineers who work in sales offices worldwide to stimulate demand by assisting customers in the use and proper selection of our products. Selling, general and administrative expenses fluctuate over time, primarily due to revenue and operating expense investment levels.

Selling, general and administrative expenses were essentially flat for the three months ended December 31, 2001 as compared to the September 30, 2001 quarter. Selling, general and administrative expenses decreased \$6.4 million, or 24.2% for the three months ended December 31, 2001 over the same period last year. Selling, general and administrative expenses decreased \$18.0 million, or 22.7%, for the nine months ended December 31, 2001 over the same period last

year. The primary reason for the dollar decreases in selling, general and administrative costs in these periods relate to reductions in bonuses and recruitment costs and one-week plant shutdowns in each of the first three quarters of fiscal 2002.

OTHER INCOME (EXPENSE)

Interest income in both the three and nine months ended December 31, 2001 decreased from the corresponding period of the previous fiscal year, although average invested cash balances were higher in both periods. The decrease in interest income was primarily driven by significantly lower interest rates applicable to our invested cash balances during the three and nine months ended December 31, 2001, as compared to the rates applying during the corresponding periods of the previous fiscal year.

PROVISION FOR INCOME TAXES

Provisions for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings. We had an effective tax rate of 26.0% for the nine months ended December 31, 2001, and 27.2% for the nine months ended December 31,

2000. We believe that our tax rate for the March 2002 quarter will be approximately 24.0%, resulting primarily from higher tax credits relating to our research and development activities. Based on our current assumptions we anticipate that our effective tax rate for the foreseeable future will be approximately 25.5%.

THE FOREGOING STATEMENTS REGARDING OUR ANTICIPATED FUTURE TAX RATES ARE FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: CURRENT TAX LAWS AND REGULATIONS; TAXATION RATES IN GEOGRAPHIC REGIONS WHERE WE HAVE SIGNIFICANT OPERATIONS; AND CURRENT TAX HOLIDAYS AVAILABLE IN FOREIGN LOCATIONS.

EURO CONVERSION ISSUES

We operate in the European Market and currently generate approximately one-third of our total net sales from customers located in Europe. Our commercial headquarters in Europe are located in the United Kingdom, which is not currently one of the 11 member states of the European Union that has converted to the Euro.

We currently conduct 97.7% of our business in Europe in U.S. Dollars and 0.2% of our business in Europe in Pounds Sterling. The balance of our net sales in Europe is conducted in the Euro. We will monitor the potential commercial impact of conversion of a portion of our current business to the Euro, but we do not currently anticipate any material impact to our business or operations based on this transition.

THE FOREGOING STATEMENT REGARDING THE ANTICIPATED IMPACT OF THE TRANSITION TO THE EURO CURRENCY IS A FORWARD-LOOKING STATEMENT. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: LEVELS OF SALES IN EUROPE THAT MAY BE CONDUCTED IN THE EURO; AND FLUCTUATIONS IN CURRENCY EXCHANGE RATES.

LIQUIDITY AND CAPITAL RESOURCES

We had \$245.4 million in cash and cash equivalents at December 31, 2001, an increase of \$115.5 million from the March 31, 2001 balance. The increase in cash and cash equivalents over this time period is primarily attributable to cash generated from operating activities. We maintain an unsecured revolving credit facility with a syndicate of banks totaling \$100.0 million. We can elect to increase the facility to \$150.0 million, subject to certain conditions set forth

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in the credit agreement. This facility has a termination date of May 31, 2003. There were no borrowings against this line of credit as of December 31, 2001. We are required to achieve certain financial ratios and operating results to maintain this line of credit and were in compliance with these requirements at December 31, 2001.

We also maintain an unsecured short-term line of credit with various financial institutions in Asia for up to \$24.6 million (U.S. dollar equivalent). There were borrowings of \$2.1 million under the foreign line of credit as of December 31, 2001, and an allocation of \$894,000 of the available line was made, relating to import guarantees associated with our business in Thailand. There are no covenants related to the foreign line of credit.

At December 31, 2001, an aggregate of \$121.6 million of our credit facilities was available, subject to financial covenants and ratios with which we were in compliance. Our ability to fully utilize our credit facilities is dependent on our remaining in compliance with such covenants and ratios.

During the nine months ended December 31, 2001, we generated \$111.5 million of cash from operating activities, a decrease of \$171.3 million from the nine months ended December 31, 2000. The decrease in cash flow from operations was primarily due to decreased profitability and the impact of changes in accounts payable and accrued liabilities, depreciation and other assets and liabilities.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the nine months ended December 31, 2001 were \$36.3 million, as compared to \$405.9 million for the nine months ended December 31, 2000. The primary reason for the dollar decrease in capital expenditures from the prior year was the reduction in the level of capacity expansion activities in response to reduced demand. Capital expenditures in the nine months ended December 31, 2001 were primarily for the addition of research and development equipment. We currently intend to spend approximately \$65 million during the next 12 months to invest in equipment to maintain, and selectively increase, capacity to meet our currently anticipated needs.

We expect to finance capital expenditures through our existing cash balances, cash flows from operations, available debt arrangements and other sources of financing, including issuance of equity and debt securities depending on market conditions. We believe that the capital expenditures anticipated to be incurred over the next 12 months will provide sufficient manufacturing capacity to meet our currently anticipated needs.

THE FOREGOING STATEMENTS REGARDING THE ANTICIPATED LEVEL OF CAPITAL EXPENDITURES OVER THE NEXT 12 MONTHS AND THE FINANCING AND SUFFICIENCY OF SUCH CAPITAL EXPENDITURES ARE FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: DEMAND FOR OUR PRODUCTS; UTILIZATION OF CURRENT MANUFACTURING CAPACITY; MARKET ACCEPTANCE OF OUR PRODUCTS AND OF OUR CUSTOMERS' PRODUCTS; THE CYCLICAL NATURE OF THE SEMICONDUCTOR INDUSTRY AND THE MARKETS ADDRESSED BY OUR PRODUCTS; THE AVAILABILITY AND COST OF RAW MATERIALS, EQUIPMENT AND OTHER SUPPLIES; AND THE ECONOMIC, POLITICAL AND OTHER CONDITIONS IN THE WORLDWIDE MARKETS SERVED BY US.

Net cash provided by financing activities was \$39.2 million for the nine months ended December 31, 2001, as compared to \$22.0 million for the nine months ended December 31, 2000. Proceeds from lines of credit were \$2.1 million for the nine months ended December 31, 2001. Repayments on lines of credit were \$9.0 million for the nine months ended December 31, 2000. Proceeds from the sale of stock and put options were \$37.1 million in the nine months ended December 31, 2001 and \$31.0 million in the nine months ended December 31, 2000.

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We had outstanding a net shares settled forward contract as of December 31, 2001. In connection with this contract, we made a net delivery of 381,763 shares of our common stock during the nine months ended December 31, 2001, and a net delivery of 478,781 shares of our common stock during the nine months ended December 31, 2000. We also received approximately \$14.1 million in connection with an early termination covering 1,100,000 of the shares outstanding in the net shares settled forward contract in the quarter ended December 31, 2001. At December 31, 2001, 1,073,737 shares remained outstanding under the contract. We closed out the net shares settled forward contract in its entirety on January 15, 2002 by making a cash payment of approximately \$27.8 million. The purchased shares are held as treasury shares and are being used to fund stock option exercises and purchases under our employee stock purchase plan.

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

ADDITIONAL FACTORS THAT MAY AFFECT RESULTS OF OPERATIONS

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

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE DUE TO FACTORS THAT COULD REDUCE OUR NET SALES AND PROFITABILITY.

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

- * demand for our products in the distribution and OEM channels
- * the level of orders that are received and can be shipped in a quarter (turns orders)
- * market acceptance both of our products and our customers' products
- * customer order patterns and seasonality
- * possible disruption in commercial activities occasioned by terrorist activity and armed conflict, such as changes in logistics and security arrangements, and reduced end-user purchases relative to expectations
- * impact of events outside the United States, such as the business impact of fluctuating currency rates or unrest or political instability
- * disruption in the supply of wafers or assembly services
- * availability of manufacturing capacity and fluctuations in manufacturing yields
- * the availability and cost of raw materials, equipment and other supplies, and
- * economic, political and other conditions in the worldwide markets served by us.

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We believe that period-to-period comparisons of our operating results are not necessarily meaningful and that you should not rely upon any comparisons as indications of future performance. In future periods, our operating results may

fall below the expectations of public market analysts and investors, which would likely have a negative effect on the price of our common stock.

OUR OPERATING RESULTS WILL SUFFER IF WE FAIL TO MAINTAIN MANUFACTURING YIELDS.

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used and the performance of our fabrication personnel and equipment. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at approximately the current levels.

INTENSE COMPETITION IN OUR MARKETS MAY LEAD TO REDUCED SALES OF OUR PRODUCTS AND REDUCED MARKET SHARE.

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources than we have with which to pursue engineering, manufacturing, marketing and distribution of their products. Emerging companies are also increasing their participation in the market for embedded control applications. In addition, our ability to compete successfully depends on a number of factors both within and outside our control, including:

- * the quality, performance, reliability, features, ease of use, pricing and diversity of our products
- * the quality of our customer services and our ability to address the needs of our customers
- * our success in designing and manufacturing new products including those implementing new technologies
- * manufacturing capacity utilization and manufacturing yields
- * hiring and retention of qualified engineering and management personnel
- * adequate supplies of raw materials and other supplies at acceptable prices
- * the rate at which customers incorporate our products into their own products
- * product introductions by our competitors
- * the number, nature and success of our competitors in a given market
- * general market and economic conditions, and
- * protection of our products and processes by effective utilization of intellectual property laws.

We may be unable to compete successfully in the future, which could harm our business.

OUR OPERATING RESULTS MAY BE IMPACTED BY THE WIDE FLUCTUATIONS OF SUPPLY AND DEMAND IN THE SEMICONDUCTOR INDUSTRY.

The semiconductor industry is characterized by wide fluctuations of supply and demand. The industry is currently experiencing a significant economic downturn, characterized by diminished product demand and production over-capacity. We have sought to reduce our exposure to this industry cyclicality by selling proprietary products, that cannot be easily or quickly replaced, to a geographically diverse base of customers across a broad range of

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market segments. However, we have experienced substantial year-to-year fluctuations in operating results and may, in the future, experience period-to-period fluctuations in operating results due to general industry or economic conditions.

WE MUST ATTRACT AND RETAIN QUALIFIED PERSONNEL TO BE SUCCESSFUL, AND COMPETITION FOR QUALIFIED PERSONNEL IS INTENSE IN OUR MARKET.

Our success depends to a significant extent upon the efforts and abilities of our senior management, engineering and other personnel. The competition for qualified engineering and management personnel is intense. We may be unsuccessful in retaining our existing key personnel or in attracting and retaining additional key personnel that we require. The loss of the services of one or more of our key personnel or the inability to add key personnel could harm our business. We have no employment agreements with any member of our senior management team.

OUR SUCCESS DEPENDS ON OUR ABILITY TO INTRODUCE NEW PRODUCTS ON A TIMELY BASIS.

Our future operating results will depend to a significant extent on our ability to develop and introduce new products on a timely basis which can compete effectively on the basis of price and performance and which address customer requirements. The success of new product introductions depends on

various factors, including:

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

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

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

WE ARE DEPENDENT ON SEVERAL THIRD-PARTY CONTRACTORS IN ASIA TO PERFORM KEY MANUFACTURING FUNCTIONS FOR US.

We depend on several third-party contractors located throughout Asia for a portion of the assembly and testing of our products and for a portion of the wafer fabrication of our analog products. Although we seek to reduce our dependence on these third-party contractors, disruption or termination of any of these sources could harm our business and operating results. Our reliance on third parties involves some reduction in our level of control over the portions of our business that we subcontract. Our future operating results could suffer if any third-party contractor were to experience financial, operations or

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production difficulties, or if they were unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.

WE MAY LOSE SALES IF OUR SUPPLIERS OF RAW MATERIALS AND EQUIPMENT FAIL TO MEET OUR NEEDS.

Our semiconductor manufacturing operations require raw materials and equipment that must meet exacting standards. We generally have more than one source for these supplies, but there are only a limited number of suppliers capable of delivering various raw materials and equipment that meet our standards. In addition, the raw materials and equipment necessary for our business could become more difficult to obtain as worldwide demand for semiconductor products increases. We have experienced supply shortages from time to time in the past, and on occasion our suppliers have told us they need more time than expected to fill our orders. An interruption of any raw materials or equipment sources could harm our business.

WE ARE HIGHLY DEPENDENT ON FOREIGN SALES AND OPERATIONS, WHICH EXPOSES US TO FOREIGN POLITICAL AND ECONOMIC RISKS.

Sales to foreign customers account for a substantial portion of our net sales. During the three and nine months ended December 31, 2001, 69% of our net sales were made to foreign customers. For the fiscal year ended March 31, 2001, approximately 68% of our net sales were made to foreign customers. We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own assembly and test facilities located near Bangkok, Thailand. We also use various third-party contractors located throughout Asia for a portion of our assembly and test requirements and a portion of our analog product wafer fabrication requirements.

INTELLECTUAL PROPERTY CLAIMS AND LITIGATION COULD SUBJECT US TO SIGNIFICANT LIABILITY FOR DAMAGES AND COULD INVALIDATE OUR PROPRIETARY RIGHTS.

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

As is typical in the semiconductor industry, we and our customers have from time to time received, and may in the future receive, communications from third parties asserting patents or other intellectual property rights on certain of our products or technologies. In the event a third party were to make a valid intellectual property claim and a license of other agreement was not available on commercially reasonable terms, our operating results could be harmed. We have in the past been, are currently, and may in the future be, involved in litigation to defend Microchip against alleged infringement of the rights of others or to enforce our intellectual property rights. Litigation could result in substantial cost to us and divert our resources. An unfavorable outcome in any such suit could harm our business, financial condition or results of operations.

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OUR MANUFACTURING FACILITIES MAY BE SUBJECT TO DISRUPTION FOR REASONS BEYOND OUR CONTROL.

Operations at any of our primary manufacturing facilities, or at any of our wafer fabrication or test and assembly subcontractors, may be disrupted for reasons beyond our control, including fire, earthquake, floods, other natural disasters, or work stoppages. If operations at any of our facilities or by any of our subcontractors are interrupted, we may not be able to shift production to other facilities on a timely basis. If this occurs, we may experience delays in shipments of products to our customers and alternate sources for production may be unavailable on acceptable terms. This could result in reduced revenues and profits and in the cancellation of orders or loss of customers.

WE ARE SUBJECT TO STRINGENT ENVIRONMENTAL REGULATION, WHICH MAY FORCE US TO INCUR SIGNIFICANT EXPENSES.

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

In 1993, TelCom acquired the semiconductor manufacturing operations of Teledyne, Inc. previously conducted at TelCom's Mountain View, California facility. The semiconductor manufacturing operations conducted by Teledyne at the facility allegedly contaminated the soil and groundwater of the facility, and the groundwater of properties located down-gradient of the facility. Although TelCom was indemnified by Teledyne against, among other things, any liabilities arising from any such contamination, and although we should be able to benefit from this indemnification as a successor to TelCom's business, we cannot assure you that claims will not be made against us or that such indemnification will be available or will provide meaningful protection at the time any such claim is brought. To the extent that we are subject to a claim that is not covered by the indemnity from Teledyne or as to which Teledyne is unable to provide indemnification, our financial condition or operating results could suffer.

THE FUTURE TRADING PRICE OF OUR COMMON STOCK COULD BE SUBJECT TO WIDE FLUCTUATIONS IN RESPONSE TO A VARIETY OF FACTORS.

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our investment portfolio, consisting of fixed income securities, was \$238.0

million as of December 31, 2001, and \$130.1 million as of March 31, 2001. These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. If market rates were to increase immediately and uniformly by 10% from the levels of December 31, 2001 and March 31, 2001, the decline in the fair value of our investment portfolio would not be material. Additionally, we have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize an adverse impact on income or cash flows.

We have international operations and are thus subject to foreign currency rate fluctuations. To date, our exposure related to exchange rate volatility has not been significant. If the foreign currency rates fluctuate by 15% from the rates at December 31, 2001 and March 31, 2001, the effect on our financial position and results of operations would not be material.

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

We believe that our market risk, as discussed in this Item 3, has not materially changed from March 31, 2001.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

10.1 Microchip Technology Incorporated 1993 Stock Option Plan, as amended through October 26, 2001.

(b) Reports on Form 8-K.

None.

22 SIGNATURES

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

MICROCHIP TECHNOLOGY INCORPORATED

Date: February __, 2002

By: /s/ Gordon W. Parnell

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

MICROCHIP TECHNOLOGY INCORPORATED
1993 STOCK OPTION PLAN
AS AMENDED THROUGH OCTOBER 26, 2001

ARTICLE I GENERAL

1.1 PURPOSE OF THE PLAN

(a) AMENDMENT. On January 19, 1993, the Board of Directors (the "Board") of Microchip Technology Incorporated, a Delaware corporation (the "Corporation") adopted the 1993 Stock Option/Stock Issuance Plan. On April 23, 1993 and September 14, 1993, the Board amended the Plan authorizing additional available shares of Common Stock. On October 7, 1993, the Board amended and restated the Plan as stated herein. On April 18, 1994, the Board amended the Plan authorizing additional available shares of Common Stock, subject to stockholder approval. On January 20, and April 26, 1995, the Board amended the Plan authorizing, among other matters, additional available shares of Common Stock, subject to stockholder approval and the elimination of the stock issuance portion of the Plan. Any options outstanding under the Plan before this amendment shall remain valid and unchanged. On April 25, 1997, the Board amended the Plan authorizing, among other matters, additional available shares of Common Stock, subject to stockholder approval. On August 18, 2000 the stockholders approved an amendment to the Plan (which was adopted by the Board on May 5, 2000) to extend its term as set forth in Section 5.3(d) hereof. The Board also amended the Plan to provide that, following the approval by the stockholders of the extension of the term of the Plan, Incentive Options could no longer be granted (see Section 2.2(e)). On October 26, 2001 the Board amended the Plan to permit the payment of the option exercise price by delivering shares of Common Stock.

(b) PURPOSE. This 1993 Stock Option Plan, amended through October 26, 2001 ("Plan"), is intended to promote the interests of the Corporation by providing (i) key employees (including officers) of the Corporation (or its parent or subsidiary corporations) who are responsible for the management, growth and financial success of the Corporation (or its parent or subsidiary corporations), (ii) non-employee members of the Corporation's Board of Directors (the "Board") and (iii) consultants and other independent contractors who provide valuable services to the Corporation (or its parent or subsidiary corporations) the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the corporation as an incentive for them to remain in the service of the Corporation (or its parent or subsidiary corporations).

(c) EFFECTIVE DATE. The Plan became effective on the first date on which the shares of the Corporation's common stock are registered under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "1934 Act"). Such date is hereby designated as the Effective Date of the Plan. The effective date of any amendments to the Plan shall be as of the date of Board approval.

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Notwithstanding the foregoing, certain amendments referenced herein must be approved by the stockholders of the Corporation.

(d) SUCCESSOR TO 1989 PLAN. This Plan shall serve as the successor to the Corporation's 1989 Stock Option Plan (the "1989 Plan"), and no further option grants or stock issuances shall be made under the 1989 Plan from and after the Effective Date of this Plan. All options outstanding under the 1989 Plan on such Effective Date are hereby incorporated into this Plan and shall accordingly be treated as outstanding options under this Plan. However, each outstanding option so incorporated shall continue to be governed solely by the express terms and conditions of the instrument evidencing such grant, and no provision of this Plan shall be deemed to affect or otherwise modify the rights or obligations of the holders of such incorporated options with respect to their acquisition of shares of the Corporation's common stock thereunder. All outstanding unvested share issuances under the 1989 Plan shall continue to be governed solely by the express terms and conditions of the instruments evidencing such issuances, and no provision of this Plan shall be deemed to affect or otherwise modify the rights or obligations of the holders of such unvested shares.

(e) PARENT/SUBSIDIARIES. For purposes of the Plan, the following provisions shall be applicable in determining the parent and subsidiary corporations of the Corporation:

(i) Any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation shall be considered to be a parent of the corporation, provided each such corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in any other corporation in such chain.

(ii) Each corporation (other than the Corporation) in an unbroken

chain of corporations beginning with the Corporation shall be considered to be a subsidiary of the Corporation, provided each such corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power all classes of stock in any other corporation in such chain.

(f) All references herein to number of shares of Common Stock have been restated reflect a 2-for-1 stock split of the Common Stock effected on September 14, 1993, a 3-for-2 stock split of the Common Stock effected on April 4, 1994, a 3-for-2 split of the Common Stock effected on November 8, 1994, a 3-for-2 split of the Common Stock effected on January 6, 1997, a 3-for-2 split of the Common Stock effected on February 7, 2000 and a 3-for-2 split of the Common Stock effected on September 26, 2001.

1.2 STRUCTURE OF THE PLAN

(a) STOCK PROGRAMS. The Plan shall be divided into two separate components: the Discretionary Option Grant Program specified in Article II and the Automatic Option Grant Program specified in Article IV. Under the Discretionary Option Grant Program, eligible individuals may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock

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in accordance with the provisions of Article II. Under the Automatic Option Grant Program, non-employee members of the Board will be automatically granted options to purchase shares of the Common Stock in accordance with the provisions of Article IV.

(b) GENERAL PROVISIONS. Unless the context clearly indicates otherwise, the provisions of Articles I and V shall apply to the Discretionary Option Grant Program and the Automatic Stock Grant Program, and shall accordingly govern the interests of all individuals under the Plan.

1.3 ADMINISTRATION OF THE PLAN

(a) BIFURCATION OF ADMINISTRATION. The eligible persons under the Discretionary Option Grant Program shall be divided into two groups and there shall be a separate administrator for each group. One group shall be comprised of eligible persons that are "Affiliates." For purposes of the Plan, the term "Affiliates" shall mean (i) all "executive officers" as that term is defined in Rule 16a-1(f) promulgated under the Securities and Exchange Act of 1934 as amended (the "1934 Act"), (ii) all directors of the Company, and (iii) all persons who own 10% or more of the Company's issued and outstanding common stock. The other group shall be comprised of all eligible persons under the Plan that are not Affiliates ("Non-Affiliates").

(b) AFFILIATE ADMINISTRATION. The power to administer the Discretionary Option Grant Program with respect to eligible persons that are Affiliates shall be vested with a committee (the "Senior Committee") of two (2) or more non-employee Board members appointed by the Board. No Board member shall be eligible to serve on the Senior Committee if such individual has, within the relevant period designated below, received an option grant or direct stock issuance under this Plan (not including any option grants made pursuant to the Automatic Option Grant Program set forth in Article IV) or any other stock plan of the Corporation (or any parent or subsidiary corporation):

(i) for each of the initial members of the Committee, the period commencing with the Effective Date of the Plan and ending with the date of his or her appointment to the Senior Committee, or

(ii) for any successor or substitute member, the twelve-month period immediately preceding the date of his or her appointment to the Senior Committee or (if shorter) the period commencing with the Effective Date of the Plan and ending with the date of his or her appointment to the Senior Committee.

(c) NON-AFFILIATE ADMINISTRATION. The power to administer the Discretionary Option Grant Program with respect to eligible persons that are not Non-Affiliates shall be vested with the Board. The Board, however, may at any time appoint a committee (the "Employee Committee") of one or more persons who are members of the Board and delegate to such Employee Committee the power, in whole or in part, to administer the Discretionary Stock Option Grant Program with respect to the Non-Affiliates.

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(d) TERM ON COMMITTEE. Members of the Senior Committee and the Employee Committee shall serve for such period of time as the Board may determine and shall be subject to removal by the Board at any time. The Board at any time may terminate the functions of the Employee Committee and reassume all powers and authority previously delegated to such Committee.

(e) AUTHORITY OF PLAN ADMINISTRATORS. The Board, the Employee Committee, and the Senior Committee, whichever is applicable, shall each be referred to herein as a "Plan Administrator." Each Plan Administrator shall have the authority and discretion, with respect to its administered group, to select which eligible persons shall participate in the Plan. Unless otherwise required

by law, decisions among members of a Plan Administrator shall be by majority vote. With respect to each administered group, the applicable Plan Administrator shall have full power and authority (subject to the express provisions of the Plan) to establish such rules and regulations as it may deem appropriate for the proper administration of the Discretionary Option Grant Program and to make such determinations under, and issue such interpretations of, the provisions of such programs and any outstanding option grants or stock issuances thereunder as it may deem necessary or advisable. All decisions made by a Plan Administrator shall be final and binding on all parties in its administered group who have an interest in the Discretionary Option Grant Program or any outstanding option thereunder. The Plan Administrator shall also have full authority to determine, with respect to the option grants made under the Discretionary Option Program, the number of shares to be covered by each such grant, the status of the granted option as either an incentive stock option ("Incentive option") which satisfies the requirements of Section 422 of the Internal Revenue Code or a non-statutory option not intended to meet such requirements, the time or times at which each granted option is to become exercisable and the maximum term for which the option may remain outstanding.

(f) INDEMNIFICATION. In addition to such other rights of indemnification as they may have, the members of each Plan Administrator shall be indemnified and held harmless by the Company, to the extent permitted under applicable law, for, from and against all costs and expenses reasonably incurred by them in connection with any action, legal proceeding to which any such member thereof may be a party, by reason of any action taken or failed to be taken, under or in connection with the Plan or any rights granted thereunder, and against all amounts paid by them in settlement thereof or paid by them in satisfaction of a judgment of any such action, suit or proceeding, except a judgment based upon a finding of bad faith.

1.4 ELIGIBLE PERSONS UNDER THE PLAN

(a) DISCRETIONARY OPTION GRANT PROGRAM. The persons eligible to participate in the Discretionary Option Grant Program under Article II are as follows:

(i) officers and other key employees of the Corporation (or its parent or subsidiary corporations) who render services which contribute to the management, growth and financial success of the Corporation (or its parent or subsidiary corporations);

(ii) non-employee members of the Board (excluding those current members of the Senior Committee); and

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(iii) those consultants or other independent contractors who provide valuable services to the Corporation (or its parent or subsidiary corporations).

(b) AUTOMATIC OPTION GRANT PROGRAM. The persons eligible to participate in the Automatic Option Grant Program shall be limited to non-employee Board members. A non-employee Board member shall not be eligible to participate in the Automatic Option Grant Program, however, if such individual has at any time been in the prior employ of the Corporation (or any parent or subsidiary corporation). Unless otherwise provided in the Plan, persons who are eligible under the Automatic Option Grant Program may also be eligible to receive option grants under the Discretionary Option Grant Program in effect under this Plan.

1.5 STOCK SUBJECT TO THE PLAN

(a) AMENDMENT(1). Under the Plan, 13,662,511 shares were originally authorized to be issued under the Plan (constituting 12,523,449 authorized shares under the 1989 Plan and rolled over into this Plan plus 1,139,062 additional shares authorized by the Board on January 19, 1993). On April 23, 1993, an additional 4,935,937 shares were authorized by the Board, subject to stockholder approval at the next stockholders' meeting. At that point, the total available authorized shares was 18,598,448. On September 14, 1993, the Board authorized the number of shares of Common Stock issuable under the Plan to be increased by 5,133,375 shares. On April 18, 1994, the Board authorized the number of shares of Common Stock issuable under the Plan to be increased by 6,581,250 shares. On January 20, 1995 and April 25, 1997, the Board authorized the number of shares of Common Stock issuable under the Plan to be increased by 3,206,250 and 4,500,000 shares, respectively, subject to Stockholder approval, such that the maximum number of shares issuable for the term of the Plan shall be as set forth in Section 1.5(b) below.

(b) AVAILABLE SHARES. Shares of the Corporation's common stock (the "Common Stock") shall be available for issuance under the Plan and shall be drawn from either the Corporation's authorized but unissued shares of Common Stock or from reacquired shares of Common Stock, including shares repurchased by the Corporation on the open market. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed 38,019,323 shares, subject to adjustment from time to time in accordance with the provisions of this Section 1.5. To the extent one or more outstanding options

under the 1989 Plan which have been incorporated into this Plan (as adjusted for the 1993 Stock Dividend) are subsequently exercised, the number of shares issued with respect to each such option shall reduce, on a share-for-share basis, the number of shares available for issuance under this Plan.

(c) ADJUSTMENTS FOR ISSUANCES. Should one or more outstanding options under this Plan (including outstanding options under the 1989 Plan incorporated into this Plan) expire or terminate for any reason prior to exercise in full, then the shares subject to the portion of each option not so exercised shall be available for subsequent option grant under the Plan. All share issuances under

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(1) All numbers are as adjusted for stock splits which have occurred through September 2000.

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the Plan, whether or not the shares are subsequently repurchased by the Corporation pursuant to its repurchase rights under the Plan, shall reduce on a share-for-share basis the number of shares of Common Stock available for subsequent option grants under the Plan. In addition, should the exercise price of an outstanding option under the Plan (including any option incorporated from the 1989 Plan) be paid with shares of Common Stock or should shares of Common Stock otherwise issuable under the Plan be withheld by the Corporation in satisfaction of the withholding taxes incurred in connection with the exercise of an outstanding option under the Plan, then the number of shares of Common Stock available for issuance under the Plan shall be reduced by the gross number of shares for which the option is exercised, and not by the net number of shares of Common Stock actually issued to the option holder.

(d) ADJUSTMENTS FOR ORGANIC CHANGES. Should any change be made to the Common Stock issuable under the Plan by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, then appropriate adjustments shall be made to (i) the maximum number and/or class of securities issuable under the Plan, (ii) the number and/or class of securities and price per share in effect under each option outstanding under either the Discretionary Option Grant Program or the Automatic Option Grant Program and (iii) the number and/or class of securities and price per share in effect under each outstanding option incorporated into this Plan from the 1989 Plan. Such adjustments to the outstanding options are to be effected in a manner which shall preclude the enlargement or dilution of rights and benefits under such options. The adjustments determined by the Board shall be final, binding and conclusive. The amount of options granted automatically under the Automatic Option Grant Program on the Annual Automatic Grant Date and on the Initial Automatic Grant Date shall not be adjusted regardless of any organic changes made to the Common Stock issuable under the Plan.

(e) LIMITATIONS ON GRANTS TO EMPLOYEES. Notwithstanding any other provision herein to the contrary, the following limitations shall apply to grants of options to Employees:

(i) No employee shall be granted, in any fiscal year of the Corporation, options to purchase more than one million twelve thousand five hundred (1,012,500) shares.

(ii) In connection with his or her initial employment, an Employee may be granted options to purchase up to an additional one million six hundred eighty-seven thousand five hundred (1,687,500) shares which shall not count against the limit set forth in subsection (i) above.

(iii) The foregoing limitations shall be adjusted proportionately in connection with any change in the Corporation's capitalization as described in Section 1.5(d).

(iv) If an option is cancelled in the same fiscal year of the Corporation in which such option was granted (other than in connection with a transaction described in Section 1.5(d)), the cancelled option will be counted against the limit set forth in Section 1.5(e)(i). For this purpose, if the exercise price of an option is reduced, the transaction will be treated as a cancellation of the option and the grant of a new option.

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ARTICLE II DISCRETIONARY OPTION GRANT PROGRAM

2.1 TERMS AND CONDITIONS OF OPTIONS

(a) GENERAL. Options granted to eligible persons ("Optionees") pursuant to the Discretionary Option Grant Program set forth in this Article II shall be authorized by action of the Plan Administrator and, at the Plan Administrator's discretion, may be either Incentive Options or non-statutory options. Individuals who are not Employees of the Corporation or its parent or subsidiary corporations may only be granted non-statutory options. Each granted option shall be evidenced by one or more instruments in the form approved by the Plan Administrator; provided, however, that each such instrument shall comply

with the terms and conditions specified below. Each instrument evidencing an Incentive Option shall, in addition, be subject to the applicable provisions of Section 2.2 hereof.

(b) OPTION PRICE. The option price per share shall be fixed by the Plan Administrator in accordance with the following provisions:

(i) The option price per share of the Common Stock subject to an Incentive Option shall in no event be less than one hundred percent (100%) of the fair market value of such Common Stock on the grant date; and

(ii) The option price per share of the Common Stock subject to a non-statutory stock option shall in no event be less than one hundred percent (100%) of the fair market value of such Common Stock on the grant date.

(c) PAYMENT OF OPTION PRICE. The option price shall become immediately due upon exercise of the option and shall be payable in one of the following alternative forms specified below:

(i) full payment in cash or check made payable to the Corporation's order; or

(ii) full payment in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at fair market value on the Exercise Date (as such term is defined below); or

(iii) full payment in a combination of shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at fair market value on the Exercise Date and cash or check drawn to the Corporation's order; or

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(iv) full payment through a broker-dealer sale and remittance procedure pursuant to which the Optionee (A) shall provide irrevocable written instructions to a designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate option price payable for the purchased shares plus all applicable Federal and State income and employment taxes required to be withheld by the Corporation in connection with such purchase and shall (B) provide written directives to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sales transaction.

For purposes of this Section 2.1(c), the Exercise Date shall be the date on which written notice of the option exercise is delivered to the Corporation. Except to the extent the sale and remittance procedure is utilized in connection with the exercise of the option, payment of the option price for the purchased shares must accompany such notice.

(d) FAIR MARKET VALUE. The fair market value per share of Common Stock shall be determined in accordance with the following provisions:

(i) If the Common Stock is not at the time listed or admitted to trading on any national stock exchange but is traded on the NASDAQ National Market System, the fair market value shall be the closing price per share on the date in question, as such price is reported by the National Association of Securities Dealers through the NASDAQ National Market System or any successor system. If there is no reported closing selling price for the Common Stock on the date in question, then the closing selling price on the last preceding date for which such quotation exists shall be determinative of fair market value.

(ii) If the Common Stock is at the time listed or admitted to trading on any national stock exchange, then the fair market value shall be the closing selling price per share on the date in question on the exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no reported sale of Common Stock on such exchange on the date in question, then the fair market value shall be the closing selling price on the exchange on the last preceding date for which such quotation exists.

(e) TERM AND EXERCISE OF OPTIONS. Each option granted under this Discretionary Option Grant Program shall be exercisable at such time or times and during such period as is determined by the Plan Administrator and set forth in the instrument evidencing the grant. No such option, however, shall have a maximum term in excess of ten (10) years from the grant date. During the lifetime of the Optionee, the option shall be exercisable only by the Optionee and shall not be assignable or transferable by the Optionee other than by will or by the laws of descent and distribution following the Optionee's death.

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(f) TERMINATION OF SERVICE. The following provisions shall govern the exercise period applicable to any outstanding options held by the Optionee at the time of cessation of Service or death:

(i) Should an Optionee cease Service for any reason (including permanent disability as defined in Section 22(e)(3) of the Internal Revenue Code but not including death) while holding one or more outstanding options under this Article II, then none of those options shall (except to the extent otherwise provided pursuant to Section 2.1(g) below) remain exercisable for more than a ninety (90) day period (or such shorter or longer period determined by the Plan Administrator and set forth in the instrument evidencing the grant, but not to exceed twelve (12) months) measured from the date of such cessation of Service.

(ii) Any option held by the Optionee under this Article II and exercisable in whole or in part on the date of his or her death may be subsequently exercised by the personal representative of the Optionee's estate or by the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution. Such exercise, however, must occur prior to the earlier of (x) six months following the date of Optionee's death or (y) the specified expiration date of the option term. Upon the occurrence of the earlier event, the option shall terminate and cease to be outstanding.

(iii) Under no circumstances, however, shall any such option be exercisable after the specified expiration date of the option term.

(iv) During the applicable post-Service exercise period, the option shall not be exercisable for more than the number of shares (if any) in which the Optionee is vested at the time of his or her cessation of Service (less any option shares subsequently purchased by the Optionee prior to death). Upon the expiration of the limited post-Service exercise period or (if earlier) upon the specified expiration date of the option term, each such option shall terminate and cease to be outstanding with respect to any vested shares for which the option has not otherwise been exercised. However, each outstanding option shall immediately terminate and cease to be outstanding, at the time of the Optionee's cessation of Service, with respect to any shares for which the option is not otherwise at that time exercisable or in which the Optionee is not otherwise at that time vested.

(v) Should (A) the Optionee's service be terminated for misconduct (including, but not limited to, any act of dishonesty, willful misconduct, fraud or embezzlement) or (B) the Optionee make any unauthorized use or disclosure of confidential information or trade secrets of the Corporation or its parent or subsidiary corporations, then in any such event all outstanding options held by the Optionee under this Article II shall terminate immediately and cease to be outstanding.

(g) DISCRETION TO ACCELERATE VESTING. The Plan Administrator shall have complete discretion, exercisable either at the time the option is granted or at any time while the option remains outstanding, to permit one or more options held by the Optionee under this Article II to be exercised, during the limited post-Service exercise period applicable under Section 2.1(f) above,

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not only with respect to the number of vested shares of Common Stock for which each such option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more subsequent installments of vested shares for which the option would otherwise have become exercisable had such cessation of Service not occurred.

(h) DISCRETION TO EXTEND EXERCISE PERIOD. The Plan Administrator shall also have full power and authority to extend the period of time for which the option is to remain exercisable following the Optionee's cessation of Service or death from the limited period in effect under Section 2.1(f) above to such greater period of time as the Plan Administrator shall deem appropriate. In no event, however, shall such option be exercisable after the specified expiration date of the option term.

(i) DEFINITIONS. For purposes of the foregoing provisions of this Section 2.1 (and for all other purposes under the Discretionary Option Grant Program):

(i) The Optionee shall (except to the extent otherwise specifically provided in the applicable stock option agreement) be deemed to remain in SERVICE for so long as such individual renders services on a periodic basis to the Corporation (or any parent or subsidiary corporation) in the capacity of an Employee, a non-employee member of the Board or an independent consultant or advisor.

(ii) The Optionee shall be considered to be an EMPLOYEE for so long as he or she remains in the employ of the Corporation or one or more parent or subsidiary corporations, subject to the control and direction of the employer entity not only as to the work to be performed but also as to the manner and method of performance.

(j) STOCKHOLDER RIGHTS. An Optionee shall have no stockholder rights with respect to any shares covered by the option until such individual shall

have exercised the option and paid the option price for the purchased shares.

(k) REPURCHASE RIGHTS. The shares of Common Stock acquired upon the exercise of any Article II option grant may be subject to repurchase by the Corporation in accordance with the following provisions:

(i) The Plan Administrator shall have the discretion to authorize the issuance of unvested shares of Common Stock under this Article II. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase any or all of those unvested shares at the option price paid per share. The terms and conditions upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the instrument evidencing such repurchase right.

(ii) All of the Corporation's outstanding repurchase rights under this Article II shall automatically terminate, and all shares subject to such terminated rights shall immediately vest in full, upon the occurrence of any Corporate Transaction under Section 2.3 hereof, except to the extent: (A) any such repurchase right is expressly assigned to the successor corporation (or

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parent thereof) in connection with the Corporate Transaction or (B) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

(iii) The Plan Administrator shall have the discretionary authority, exercisable either before or after the Optionee's cessation of Service, to cancel the Corporation's outstanding repurchase rights with respect to one or more shares purchased or purchasable by the Optionee under this Discretionary Option Grant Program and thereby accelerate the vesting of such shares in whole or in part at any time.

2.2 INCENTIVE OPTIONS

(a) GENERAL. The terms and conditions specified below shall be applicable to all incentive options ("Incentive Options") granted under this Article II pursuant to Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). Incentive Options may only be granted to individuals who are employees of the Corporation. Options which are specifically designated as "non-statutory" options when issued under the Plan shall NOT be subject to such terms and conditions.

(b) DOLLAR LIMITATION. The aggregate fair market value (determined as of the respective date or dates of grant) of the Common Stock for which one or more Incentive Options granted to any Employee under this Plan (or any other option plan of the Corporation or its parent or subsidiary corporations) may for the first time become exercisable during any one calendar year shall not exceed the sum of One Hundred Thousand Dollars (\$100,000). To the extent the Employee holds two or more such Incentive Options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options under the federal tax laws shall be applied on the basis of the order in which such Incentive Options are granted. Should the number of shares of Common Stock for which any Incentive Option first becomes exercisable in any calendar year exceed the applicable One Hundred Thousand Dollar (\$100,000) limitation, then that option may nevertheless be exercised in that calendar year for the excess number of shares as a non-statutory option under the federal tax laws.

(c) 10% STOCKHOLDER. If any individual to whom an Incentive Option is granted is the owner of stock (as determined under Code Section 424(d)) possessing ten percent (10%) or more of the total combined voting power of all classes of stock of the Corporation or any one of its parent or subsidiary corporations, then the option price per share shall not be less than one hundred and ten percent (110%) of the fair market value per share of Common Stock on the grant date, and the option term shall not exceed five years, measured from the grant date.

(d) APPLICATION. Except as modified by the preceding provisions of this Section 2.2, the provisions of Articles I, II and V of the Plan shall apply to all Incentive Options granted hereunder.

(e) NO INCENTIVE OPTIONS AFTER AUGUST 18, 2000. From and after August 18, 2000, no Incentive Options shall be granted under the Plan.

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2.3 CORPORATE TRANSACTIONS

(a) DEFINITION. For purposes of this Plan, any of the following stockholder approved transactions to which the Corporation is a party shall be considered a "Corporate Transaction":

(i) a merger or consolidation in which the corporation is not the surviving entity, except for a transaction the principal purpose of which is to

change the State in which the Corporation is incorporated,

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Corporation in complete liquidation or dissolution of the Corporation, or

(iii) any reverse merger in which the Corporation is the surviving entity but in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to person or persons different from those who held such securities immediately prior to such merger.

(b) ACCELERATION OF OPTION. Upon the stockholder approval of a Corporate Transaction, each option which is at the time outstanding under this Article II shall automatically accelerate so that each such option shall, immediately prior to the specified effective date for the Corporate Transaction, become fully exercisable with respect to the total number of shares of Common Stock at the time subject to such option and may be exercised for all or any portion of such shares. However, an outstanding option under this Article II shall not so accelerate if and to the extent: (A) such option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation or parent thereof or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation or parent thereof, (B) such option is to be replaced with a cash incentive program of the successor corporation which preserves the option spread existing at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to such option, or (C) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant. The determination of option comparability under clause (A) above shall be made by the Plan Administrator, and its determination shall be final, binding and conclusive.

(c) TERMINATION OF OPTIONS. Upon the consummation of the Corporate Transaction, all outstanding options under this Article II shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation or its parent company.

(d) ADJUSTMENTS ON ASSUMPTION OR CONTINUATION. Each outstanding option under this Article II which is assumed in connection with the Corporate Transaction or is otherwise to continue in effect shall be appropriately adjusted, immediately after such Corporate Transaction, to apply and pertain to the number and class of securities which would have been issued to the option holder, in consummation of such Corporate Transaction, had such person exercised the option immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to the option price payable per share, provided the aggregate option price payable for such securities shall remain the same. In

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addition, the class and number of securities available for issuance under the Plan following the consummation of the Corporate Transaction shall be appropriately adjusted.

(e) DISCRETION TO ACCELERATE. The Plan Administrator shall have the discretion, exercisable either in advance of any actually-anticipated Corporate Transaction or at the time of an actual Corporate Transaction, to provide (upon such terms as it may deem appropriate) for the automatic acceleration of one or more outstanding options granted under the Plan which are assumed or replaced in the Corporate Transaction and do not otherwise accelerate at that time, in the event the Optionee's Service should subsequently terminate within a designated period following the effective date of such Corporate Transaction.

(f) PLAN NOT TO AFFECT CORPORATION. The grant of options under this Article II shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

2.4 CHANGE IN CONTROL

(a) DEFINITION. For purposes of this Plan, a Change in Control shall be deemed to occur in the event:

(i) any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) directly or indirectly acquires beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board does not recommend such stockholders to accept; or

(ii) there is a change in the composition of the Board over a period of twenty-four (24) consecutive months or less such that a majority of the Board members (rounded up to the next whole number) ceases, by reason of one or more proxy contests for the election of Board members, to be comprised of

individuals who either (a) have been Board members continuously since the beginning of such period or (b) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (a) who were still in office at the time such election or nomination was approved by the Board.

(b) DISCRETION TO ACCELERATE. The Plan Administrator shall have the discretionary authority, exercisable either in advance of any actually anticipated Change in Control or at the time of an actual Change in Control, to provide for the automatic acceleration of one or more outstanding options under this Article II (and the termination of one or more of the Corporation's outstanding repurchase rights under this Article II) upon the occurrence of the Change in Control. The Plan Administrator shall also have full power and authority to condition any such option acceleration (and the termination of any outstanding repurchase rights) upon the subsequent termination of the Optionee's Service within a specified period following the Change in Control.

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(c) EXERCISE RIGHTS. Any options accelerated in connection with the Change in Control shall remain fully exercisable until the expiration or sooner termination of the option term.

2.5 INCENTIVE OPTIONS

The exercisability as Incentive Options of any options accelerated under Sections 2.3 or 2.4 hereof in connection with a Corporate Transaction or Change in Control shall remain subject to the dollar limitation of Section 2.2 hereof.

ARTICLE III RESERVED

ARTICLE IV AUTOMATIC OPTION GRANT PROGRAM

4.1 TERMS AND CONDITIONS OF AUTOMATIC OPTION GRANTS

(a) AMOUNT AND DATE OF GRANT. During the term of this Plan, automatic option grants (the "Automatic Option Grant") shall be made to each eligible non-employee member of the Board ("Optionee") as follows:

(i) Each year on the Annual Automatic Grant Date an option to acquire 5,000 shares of Common Stock ("Option Shares") shall be granted to each eligible non-employee member of the Board for so long as there are shares of Common Stock available under Section 1.5 hereof. The "Annual Automatic Grant Date" shall be as of the first business day of the month in which the Corporation's Annual Stockholders Meeting is held. Notwithstanding the foregoing, (1) any non-Employee Member of the Board whose term ended as of such Automatic Grant Date shall not be eligible to receive any automatic option grants on that Annual Automatic Grant Date and (2) any non-Employee Member of the Board who has received an Automatic Grant pursuant to Section 4.1(a)(ii) on the same date as the Annual Automatic Grant Date or within 30 days prior thereto, shall not be eligible to receive an Automatic Option Grant on that Annual Automatic Grant Date.

(ii) On the Initial Automatic Grant Date, every new member of the Board who is an eligible non-Employee and has not previously been a member of the Board shall be granted an option to acquire 10,000 shares of Common Stock ("Option Shares") as long as there are shares of Common Stock available under Section 1.5 hereof. The "Initial Automatic Grant Date" shall be as of the date that the Optionee was first appointed or elected to the Board.

(b) EXERCISE PRICE. The exercise price per share of Common Stock subject to each automatic option grant made under this Article IV shall be equal to 100% of the fair market value per share of the Common Stock on the applicable Automatic Grant Date, as determined in accordance with the valuation provisions of Section 2.1(d) hereof.

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(c) METHOD OF EXERCISE. In order to exercise an option with respect to any Option Shares for which an Automatic Option Grant is exercisable at the time, Optionee (or in the case of an exercise after Optionee's death, Optionee's executor, administrator, heir or legatee, as the case may be) must take the following action:

(i) execute and deliver to the Secretary of the Company a written notice of exercise;

(ii) pay the aggregate Option Price in one of the alternate forms as set forth in Section 4.1(d) below; and

(iii) furnish appropriate documentation that the person or persons exercising the option (if other than the Optionee) has the right to exercise such option. As soon after the Exercise Date (as defined in Section 4.1(e) hereof), as practical, the Company shall mail or deliver to or on behalf

of the Optionee (or any other person or persons exercising this option in accordance herewith) a certificate or certificates representing the shares for which the option has been exercised in accordance with the provisions of this Plan. In no event may any option be exercised for any fractional shares.

(d) PAYMENT PRICE. The exercise price shall be payable in one of the alternative forms specified below:

(i) full payment in cash or check made payable to the Corporation's order; or

(ii) full payment in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at fair market value on the Exercise Date (as such term is defined below); or

(iii) full payment in a combination of shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at fair market value on the Exercise Date and cash or check drawn to the Corporation's order; or

(iv) full payment through a sale and remittance procedure pursuant to which the non-employee Board member (A) shall provide irrevocable written instructions to a designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares and shall (B) concurrently provide written directives to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sales transaction.

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For purposes of this Section 4.1.(d), the Exercise Date shall be the date on which written notice of the option exercise is delivered to the Corporation. Except to the extent the sale and remittance procedure is utilized in connection with the exercise of the option, payment of the exercise price for the purchased shares must accompany such notice.

(e) EXERCISE DATE. For purposes of this Article IV, the Exercise Date shall be the date on which written notice of the option exercise is delivered to the Corporation, and the fair market value per share of Common Stock on any relevant date under this Article IV shall be determined in accordance with the provisions of Section 2.1(d) hereof. Except to the extent the sale and remittance procedure specified above is utilized for the exercise of the option, payment of the option price for the purchased shares must accompany the exercise notice.

(f) TERM OF OPTION. Each automatic option grant under this Article IV shall have a maximum term of ten (10) years measured from the Automatic Grant Date. Should Optionee's service as a Board member cease for any reason while an option remains outstanding and unexercised, then the option term shall immediately terminate and the option shall cease to be outstanding prior to the Expiration Date in accordance with the following provisions:

(i) The option shall immediately terminate and cease to be outstanding for any shares of Common Stock for which the option was not otherwise exercisable at the time of Optionee's cessation of Board service.

(ii) Should Optionee cease, for any reason other than death, to serve as a member of the Board, then Optionee shall have a six-month period measured from the date of such cessation of Board service in which to exercise the options which vested prior to the time of such cessation of Board service. In no event, however, may any option be exercised after the Expiration Date of such option.

(iii) Should Optionee die while serving as a Board member or within six months after cessation of Board service, then the personal representative of the Optionee's estate (or the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution) shall have the right to exercise any option for any or all of the shares of Common Stock for which the option is, in accordance with the provisions of this Plan, exercisable at the time of the Optionee's cessation of Board service, less any shares subsequently purchased by the Optionee pursuant to the option prior to death. Such right shall cease to be exercisable and the option shall accordingly terminate with respect to all Common Stock available under such option by the earlier of (A) the expiration of the twelve-month period measured from the date of Optionee's death or (B) the Expiration Date.

(g) VESTING. Each Automatic Option Grant made pursuant to Section 4.1(a)(i) shall become exercisable and vest in a series of twelve (12) equal and successive monthly installments, with the first such installment to become exercisable one month after the Annual Automatic Grant Date. Each Automatic Option Grant made pursuant to Section 4.1(a)(ii) shall become exercisable and vest in a series of 36 equal and successive monthly installments, with the first

such installment to become exercisable one month after the Initial Automatic

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Grant Date. Each installment of an option shall only vest and become exercisable if the Optionee has not ceased serving as a Board member as of such installment date.

(h) LIMITED TRANSFERABILITY. Each Automatic Option Grant shall be exercisable only by Optionee during Optionee's lifetime and shall be neither transferable nor assignable, other than by will or by the laws of descent and distribution following Optionee's death.

4.2 CORPORATE TRANSACTION

In the event of stockholder approval of a Corporate Transaction (as that term is defined in Section 2.3(a)), then all options granted pursuant to this Article IV (to the extent outstanding at such time, but not otherwise fully exercisable and vested) shall automatically accelerate and immediately vest so that the option shall, immediately prior to the specified effective date for the Corporate Transaction, become fully exercisable for all of the Option Shares at the time subject to the option and may thereafter be exercised for any or all such Option Shares. Upon the consummation of the Corporate Transaction, the option shall, to the extent not previously exercised, terminate and cease to be outstanding.

4.3 CHANGE IN CONTROL

All options granted pursuant to an Automatic Option Agreement under this Article IV (to the extent outstanding, but not otherwise fully exercisable and vested) shall automatically accelerate in connection with a Change in Control (as that term is defined in Section 2.4(a)), so that such option shall, immediately prior to the effective date of such Change in Control, become fully exercisable for all of the Option Shares at the time subject to that option and may be exercised for any or all of such Option Shares. The option shall remain so exercisable until such option has terminated in accordance with Section 4.1(d) hereof.

4.4 MISCELLANEOUS PROVISIONS

(a) CORPORATION RIGHTS. The Automatic Option Grants shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

(b) PRIVILEGE OF STOCK OWNERSHIP. An Optionee shall not have any of the rights of a stockholder with respect to Option Shares until such individual shall have exercised the option and paid the option price for the Option Shares.

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ARTICLE V MISCELLANEOUS

5.1 AMENDMENT OF THE PLAN AND AWARDS

(a) BOARD AUTHORITY. The Board has complete and exclusive power and authority to amend or modify the Plan (or any component thereof) in any or all respects whatsoever. However, no such amendment or modification shall, without the consent of the Corporation's stockholders, disqualify any option previously granted under the Plan for treatment as an Incentive Option, or adversely affect rights and obligations with respect to options at the time outstanding under the Plan, unless the Optionee or Participant consents to such amendment. In addition, the Board may not, without the approval of the Corporation's stockholders, amend the Plan to (i) materially increase the maximum number of shares issuable under the Plan, except for permissible adjustments under Section 1.5(d) or extend the term of the Plan, (ii) materially modify the eligibility requirements for plan participation or (iii) materially increase the benefits accruing to plan participants.

(b) OPTIONS ISSUED PRIOR TO STOCKHOLDER APPROVAL. Options to purchase shares of Common Stock may be granted under the Discretionary Option Grant Program and the Automatic Option Grant Program prior to any required stockholder approvals, provided, any shares actually issued under the Plan are held in escrow until stockholder approval is obtained. If such stockholder approval is not obtained within twelve (12) months of the meeting of the Board approving the Plan or any amendments, then (i) any unexercised options shall terminate and cease to be exercisable and (ii) the Corporation shall promptly refund the purchase price paid for any excess shares actually issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow.

(c) RULE 16b-3 PLAN. With respect to persons subject to Section 16 of the 1934 Act, the Plan is intended to comply with all applicable conditions of Rule 16b-3 (and all subsequent revisions thereof) promulgated under the 1934 Act. To the extent any revision of the Plan or action by any Plan Administrator

fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by such Plan Administrator. In addition, the Board may amend the Plan from time to time as it deems necessary in order to meet the requirements of any amendments to Rule 16b-3 without the consent of the shareholders of the Company.

5.2 TAX WITHHOLDING

(a) GENERAL. The Corporation's obligation to deliver shares of Common Stock upon the exercise of stock options for such shares or the vesting of such shares under the Plan shall be subject to the satisfaction of all applicable Federal, State and local income tax and employment tax withholding requirements.

(b) SHARES TO PAY FOR WITHHOLDING. A Plan Administrator may, in its discretion and in accordance with the provisions of this Section 5.2(b) and such supplemental rules as the Plan Administrator may from time to time adopt

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(including the applicable safe-harbor provisions of SEC Rule 16b-3), provide any or all holders of non-statutory options or unvested shares under the Plan with the right to use shares of the Corporation's Common Stock in satisfaction of all or part of the Federal, State and local income tax and employment tax liabilities incurred by such holders in connection with the exercise of their options or the vesting of their shares (the "Taxes"). Such right may be provided to any such holder in either or both of the following formats:

(i) STOCK WITHHOLDING. The holder of the non-statutory option or unvested shares may be provided with the election to have the Corporation withhold, from the shares of Common Stock otherwise issuable upon the exercise of such non-statutory option or the vesting of such shares, a portion of those shares with an aggregate fair market value equal to the percentage of the applicable Taxes (not to exceed one hundred percent (100%)) designated by the holder.

(ii) STOCK DELIVERY. The Plan Administrator may, in its discretion, provide the holder of the non-statutory option or the unvested shares with the election to deliver to the Corporation, at the time the non-statutory option is exercised or the shares vest, one or more shares of Common Stock previously acquired by such individual (other than pursuant to the transaction triggering the Taxes) with an aggregate fair market value equal to the percentage of the taxes incurred in connection with such option exercise or share vesting (not to exceed one hundred percent (100%)) designated by the holder.

5.3 EFFECTIVE DATE AND TERM OF PLAN

(a) EFFECTIVE DATE. This Plan, as successor to the Corporation's 1989 Stock Option Plan, become effective as of the applicable Effective Date, and no further option grants or stock issuances shall be made under the 1989 Plan from and after such Effective Date.

(b) INCORPORATION OF 1989 PLAN. Each option issued and outstanding under the 1989 Plan immediately prior to the Effective Date of the Discretionary Option Grant Program shall be incorporated into this Plan and treated as an outstanding option under this Plan, but each such option shall continue to be governed solely by the terms and conditions of the instrument evidencing such grant, and nothing in this Plan shall be deemed to affect or otherwise modify the rights or obligations of the holders of such options with respect to their acquisition of shares of Common Stock thereunder.

(c) DISCRETION. The option and vesting acceleration provisions of Article II relating to Corporate Transactions and Changes in Control may, in the Plan Administrator's discretion, be extended to one or more stock options which are outstanding under the 1989 Plan on the Effective Date of the Discretionary Option Grant Program but which do not otherwise provide for such acceleration.

(d) TERMINATION OF PLAN. The Plan shall terminate upon the earlier of (i) January 19, 2013(2) or (ii) the date on which all shares available for issuance under the Plan shall have been issued pursuant to the exercise of options granted under the Plan. If the date of termination is determined under clause (i) above, then all option grants and unvested stock issuances

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(2) By amendment approved by the stockholders on August 18, 2000, the term of the Plan was extended from January 19, 2003 to January 19, 2013.

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outstanding on such date shall thereafter continue to have force and effect in accordance with the provisions of the instruments evidencing such grants or issuances.

5.4 USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares pursuant to option grants under the Plan shall be used for general corporate

purposes.

5.5 REGULATORY APPROVALS

(a) GENERAL. The implementation of the Plan, the granting of any option under the Plan, and the issuance of Common Stock upon the exercise or surrender of the option grants made hereunder shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it, and the Common Stock issued pursuant to it.

(b) SECURITIES REGISTRATION. No shares of Common Stock or other assets shall be issued or delivered under this Plan unless and until there shall have been compliance with all applicable requirements of Federal and State securities laws, including the filing and effectiveness of the Form S-8 registration statement for the shares of Common Stock issuable under the Plan, and all applicable listing requirements of any securities exchange on which stock of the same class is then listed.

5.6 NO EMPLOYMENT/SERVICE RIGHTS

Neither the action of the Corporation in establishing the Plan, nor any action taken by the Plan Administrator hereunder, nor any provision of the Plan shall be construed so as to grant any individual the right to remain in the employ or service of the Corporation (or any parent or subsidiary corporation) for any period of specific duration, and the Corporation (or any parent or subsidiary corporation retaining the services of such individual) may terminate such individual's employment or service at any time and for any reason, with or without cause.

5.7 MISCELLANEOUS PROVISIONS

(a) ASSIGNMENT. The right to acquire Common Stock or other assets under the Plan may not be assigned, encumbered or otherwise transferred by any Optionee or Participant. The provisions of the Plan shall inure to the benefit of, and be binding upon, the Corporation and its successors or assigns, whether by Corporate Transaction or otherwise, and the Participants and Optionees, the legal representatives of their respective estates, their respective heirs or legatees and their permitted assignees.

(b) CHOICE OF LAW. The provisions of the Plan relating to the exercise of options and the vesting of shares shall be governed by the laws of the State of Arizona, as such laws are applied to contracts entered into and performed in such State.

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(c) PLAN NOT EXCLUSIVE. This Plan is not intended to be the exclusive means by which the Corporation may issue options or warrants to acquire its shares of Common Stock, stock awards or issuances, or any other type of award or issuance. To the extent permitted by applicable law, any such other option, warrants, issuance, or awards may be issued by the Company, other than pursuant to this Plan, without shareholder approval.

EXECUTED as of the 26th day of October, 2001.

MICROCHIP TECHNOLOGY CORPORATION,
a Delaware corporation

By: /s/ Steve Sanghi

Steve Sanghi

Its: Chairman of the Board, President and Chief
Executive Officer

Attested by:

/s/ Mary K. Simmons

Mary K. Simmons, Secretary