

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange
Act of 1934

For the fiscal year ended March 31, 1998 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 86-0629024
(State of Incorporation) (I.R.S. Employer Identification No.)

2355 W. Chandler Blvd., Chandler, AZ 85224
(Address of Principal Executive Offices, Including Zip Code)

(602) 786-7200
(Registrant's Telephone Number, Including Area Code)

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

None

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

Common Stock, \$.001 Par Value Per Share
Preferred Share Purchase Rights

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 and (2) has been subject to such filing requirements for the past 90 days.

Yes No
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of Form 10-K or any amendment to this Form 10-K. (X)

The approximate aggregate market value of the voting stock of the registrant beneficially owned by stockholders, other than directors, officers and affiliates of the registrant, at April 26, 1998 was \$1,497,258,399.

Number of shares of Common Stock, \$.001 par value, outstanding as of April 26, 1998 was: 52,870,389.

Documents Incorporated by Reference

| Document | Part of Form 10-K |
|-------------------------------------------------------------|-------------------|
| Proxy Statement for the 1998 Annual Meeting of Stockholders | III |

PART I

Item 1. BUSINESS

Microchip Technology Incorporated, a Delaware corporation ("Microchip" or the "Company"), develops, manufactures and markets 8-bit microcontrollers, application-specific standard products (ASSPs) and related memory products for high-volume embedded control applications in the consumer, automotive, office automation, communications and industrial markets. The Company provides highly cost-effective embedded control products for a wide variety of applications and believes that its PIC(R) product family is a price/performance leader in the worldwide 8-bit microcontroller market. Microchip's embedded control products also offer the advantages of a small footprint and low voltage operation along

with ease of development, enabling timely and cost-effective product integration by its customers. The Company's ASSP products include a variety of specialized integrated circuits, including its family of KEELOQ(R) security products. The Company's memory products are primarily comprised of Serial EEPROMs, which are used primarily to provide non-volatile memory storage in embedded control systems.

Except as noted below, references to the Company include the Company and its subsidiaries. The Company's executive offices are located at 2355 West Chandler Boulevard, Chandler, Arizona 85224-6199 and its telephone number is (602) 786-7200.

The following discussion of the Company's business contains certain risk factors that may affect future operating results. For further discussion on certain risk factors that may affect the Company's future operating results, see "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation," below.

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934 which involve risks and uncertainties, including statements regarding the Company's strategy, financial performance, and revenue sources. The Company's actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report.

Industry Background

Competitive pressures increasingly require manufacturers to expand product functionality and provide differentiation while maintaining or reducing cost. To address these requirements, manufacturers increasingly use integrated circuit-based embedded control systems which provide an integrated solution for application-specific control requirements. Embedded control systems enable manufacturers to differentiate their products, replace less efficient electromechanical control devices, add product functionality and significantly reduce product costs. In addition, embedded control systems facilitate the emergence of complete new classes of products. Embedded control systems have been incorporated into thousands of products and subassemblies in a wide variety of markets worldwide, including automotive air bag systems, remote control devices, handheld tools, appliances, portable computers, cordless and cellular telephones, motor controls and security systems.

Embedded control systems typically incorporate a microcontroller as the principal active, and sometimes sole, component. A microcontroller is a self-contained computer-on-a-chip consisting of a central processing unit, non-volatile program memory, RAM memory for data storage and various input/output functions. In addition to the microcontroller, a complete embedded control system incorporates application-specific software and may include specialized peripheral device controllers and external non-volatile memory components, such as EEPROMs, to store additional program software.

The increasing demand for embedded control has made the market for microcontrollers one of the largest segments of the semiconductor logic market. Microcontrollers are currently available in 4-bit through 32-bit architectures. Although 4-bit microcontrollers are relatively inexpensive, typically costing under \$1.00 each, they generally lack the minimum performance and features required by today's design engineers for product differentiation and are typically used only to produce basic functionality in products. While 16- and 32-bit architectures provide very high performance, they are prohibitively expensive for most high-volume embedded control applications, typically costing over \$5.00 each. As a result, manufacturers of competitive, high-volume products have increasingly found 8-bit microcontrollers, that typically cost \$1.00 to \$8.00 each, to be the most cost-effective embedded control solution. For example, a typical new automobile may include one 32-bit microcontroller for engine control, three 16-bit microcontrollers for transmission control, audio systems and anti-lock braking, and up to 50 8-bit microcontrollers to provide other embedded control functions, such as door locking, automatic windows, sun roof, adjustable seats, electric mirrors, air bags, fuel pump, speedometer, and the security and climate control systems.

Most microcontrollers available today are ROM-based and must be programmed by the semiconductor supplier during manufacturing, resulting in six-to-20 week lead times for delivery of such microcontrollers. In addition to delayed product introduction, these long lead times can result in potential inventory obsolescence and factory shutdowns when changes to the firmware are required. To address time-to-market constraints, some suppliers have made EPROM-, EEPROM-, or Flash Memory-based programmable microcontrollers available for prototyping and preproduction runs. However, these microcontrollers have been relatively expensive, and manufacturers have still been required to send program code to the semiconductor factory for ROM programming as product changes are made. As a result, the long lead times for production volume microcontrollers have not been significantly reduced by traditional approaches.

Products

Microchip's strategic focus is on embedded control products, including microcontrollers, ASSPs, related memory products and application development systems.

Microcontrollers

Microchip offers a broad family of proprietary 8-bit microcontrollers under the PIC(R) name and has shipped approximately 600 million PIC(R) microcontrollers to customers worldwide since 1990. The Company's PIC(R) products are designed for applications requiring high performance and low cost. They feature a variety of memory configurations, low voltage and power, small footprint and ease of use. Microchip believes this product family is currently a price/performance leader in the 8-bit microcontroller marketplace. Microchip's performance results from an exclusive RISC-based architecture that provides significant speed advantages over the alternative 8-bit CISC architectures. In addition to providing up to 40 MHz performance, this architecture offers up to a 2:1 software compaction advantage, thereby significantly reducing software development time. RISC architectures also have the advantage of being more easily scaled to higher internal clock speeds in future products. Prices for Microchip's 8-bit microcontrollers range from approximately \$.49 to \$12.00 per unit.

Microchip's original market focus was in the lowest cost segment of the 8-bit microcontroller marketplace. With its baseline 8-bit products, the Company built its current market position as the leading supplier of field programmable microcontrollers. Over the past three years, Microchip has introduced more than 100 new 8-bit microcontrollers targeted at baseline, mid-range and high-end segments of the 8-bit microcontroller marketplace, as well as the lower end of the 16-bit microcontroller market. In addition, with its 8-pin, 8-bit microcontroller, introduced in the first quarter of fiscal 1997, the Company has also targeted a portion of the large 4-bit microcontroller marketplace. The Company believes that these additional segments represent a significant opportunity for future sales growth.

Microchip has used its manufacturing experience and design and process technology to bring additional enhancements and manufacturing efficiencies to the development and production of its PIC(R) family of microcontroller products. This extensive experience base has enabled the Company to develop its advanced, low cost user programmability feature by incorporating non-volatile memory (EPROM, EEPROM and Flash Memory) into the microcontroller in addition to masked ROM program memory.

Development Systems

The Company offers a comprehensive set of low cost and easy-to-learn application development tools. These tools enable system designers to quickly and easily program a PIC(R) microcontroller for specific applications and are a key factor for obtaining design wins. Microchip's family of development tools operates in the standard Windows environment on standard PC hardware. Entry-level systems, which include an assembler and programmer hardware, are priced at less than \$200. A fully configured system, which also provides in-circuit emulation hardware, performance simulators and software debuggers, is priced at approximately \$3,700. Customers moving from entry-level designs to those requiring real-time emulation are able to preserve their investment in software tools as they migrate to future PIC(R) devices since all the product families are assembly- and C- language compatible.

Many independent companies also develop and market application development tools and systems which support Microchip's standard microcontroller product architecture. The Company believes that familiarity with and adoption of the Company's, and third-party, development systems by an increasing number of product designers will be an important factor

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in the future selection of Microchip's embedded control products. These development tools allow design engineers to develop thousands of application-specific products from Microchip's standard microcontrollers. Currently, there are more than 120 third-party tool suppliers worldwide whose products support the Company's proprietary microcontroller architecture.

ASSPs (Application-Specific Standard Products)

Microchip's application-specific standard products are specialized products designed to perform specific end-user applications as opposed to the Company's other products which are more general purpose in nature. The Company's ASSP device families currently include the KEELOQ(R) family of secure data transmission products, as well as other specialized integrated circuit devices. KEELOQ(R) security products are designed for low cost, secure, uni-directional communications and verification purposes. Applications include automotive remote keyless entry systems, automotive immobilizer systems, automatic garage and gate openers and smart cards.

Memory Products

Microchip's memory products consist primarily of Serial EEPROMs. The

Company sells these devices primarily into the embedded control market and is the third largest supplier of such devices worldwide. EEPROM (electrically erasable programmable read only memory) products are used for non-volatile program and data storage in systems where such data must be modified frequently. Serial EEPROMs have a very low I/O pin requirement, permitting production of very small devices. As a result, Serial EEPROMs are widely used to supply non-volatile memory in space-sensitive applications such as portable computers, cellular and cordless telephones, pagers and remote control devices.

Within this market, Microchip has emphasized providing Serial EEPROMs to customers that require features such as highly compact packaging, low operating voltage, reduced power consumption, extended data retention and high endurance. The Company addresses these requirements by offering products with extremely small package sizes and very low operating voltage for both read and write functions (1.8 volts in contrast with the industry standard of 3.3 volts), together with a wide operating voltage range (1.8 to 5.5 volts). High performance circuitry and microcode are also available to reduce power consumption when a device is not in use, while permitting immediate operating capability when required. The products also feature long data retention and high erase/write endurance.

Microchip currently offers a complete Serial EEPROM family, which meets three principal industry bus interface standards and is available in most standard density, configuration and packaging alternatives. The Company's Smart Serials(TM) line of specialized Serial EEPROMs with user-configurable architecture and other advanced features targets applications such as cellular telephones and data communications.

Manufacturing

Microchip's ownership of its manufacturing resources is an important component of its business strategy, enabling it to maintain a high level of manufacturing control and to be one of the lowest cost producers in the embedded control industry. By owning its wafer fabrication and the majority of its test operations, and by employing proprietary statistical process control techniques, the Company has been able to achieve high production yields. Direct control over wafer fabrication also allows Microchip to shorten the Company's design and production cycles and to capture the manufacturing and a portion of the testing profit margin. Wafer fabrication and wafer test facilities are located in Chandler ("Fab 1") and Tempe ("Fab 2"), Arizona. The Company performs product test at its facilities in Kaohsiung, Taiwan and Chachoengsao, Thailand, located near Bangkok.

Wafers are produced in Class 10 fabrication modules in Fab 1 and Fab 2. Fab 1 currently contains approximately 27,000 square feet. Fab 2 has approximately 50,000 square feet of useable clean room space of which approximately 40,000 square feet are used to support current production requirements. Fab 1 currently produces 5-inch and 6-inch wafers, while Fab 2 currently produces 6-inch and 8-inch wafers. Wafer sort is performed in an 8,000 square foot, Class 10,000 clean room, equipped with automated wafer handlers and test equipment. The two wafer fabrication sites are managed by the same management team and utilize similar production techniques.

The Company is continuing the process of transitioning products to smaller geometries and to larger wafer sizes. The Company has transitioned a portion of its products to a 0.7 micron process and has commenced development of its next generation process technology. Other companies in the industry have experienced difficulty in effecting transitions to

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smaller geometry processes and to larger wafers and, consequently, have experienced reduced manufacturing yields or delays in product deliveries. The Company believes that its transition to smaller geometries and to larger wafers will be important for the Company to remain competitive and operating results, particularly gross profit margins, could be adversely affected if the Company's transition is substantially delayed or inefficiently implemented.

Microchip currently employs proprietary design and manufacturing processes in developing its microcontroller and memory products. The Company believes its processes afford it both cost-effective designs in existing and derivative products and greater functionality in new product designs. While many of the Company's competitors develop and optimize separate processes for their logic and memory product lines, Microchip uses a common process technology for both microcontroller and non-volatile memory products. This allows Microchip to more fully absorb its process research and development costs and to deliver new products to market more rapidly. Microchip engineers utilize advanced CAD tools and software to perform circuit design, simulation and layout. The Company's in-house photomask and wafer fabrication facilities enable it to rapidly verify design techniques by processing test wafers quickly and efficiently.

The Company's Taiwan and Thailand subsidiaries test the majority of the products produced in Fab 1 and Fab 2. Currently, the 150,000 square foot Chachoengsao test facility has the capacity to handle up to 30 million units per month. If required, the Chachoengsao facility could be expanded in the future to more than double its current capacity. The 88,700 square foot Kaohsiung facility has a monthly capacity of 19 million plastic packages. Final test and burn-in

functions are handled by advanced automated equipment. The Company uses third-party contractors in Bangkok, Thailand to assemble a significant portion of its products. The balance of Microchip's assembly and test requirements are fulfilled by several third-party assembly and test contractors in Thailand, the Philippines, People's Republic of China, and several other countries in Asia and the Pacific Rim.

Over the last several years, Microchip shifted its assembly operations from Company-owned facilities to third-party contractors in order to meet increased product shipment requirements. At March 31, 1998, all assembly was conducted by third-party contractors. The Company will continue to use third-party contractors to provide a majority of its assembly services. Reliance on third parties involves some reduction in the Company's level of control over the assembly and test portion of its business. While the Company reviews the quality, delivery and cost performance of these third-party contractors, there can be no assurance that increased reliance on third-party contractors will not adversely impact results in future reporting periods if any third-party contractor is unable to maintain assembly and test yields and costs at approximately their current levels. See also "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Gross Profit," below.

The Company's reliance on facilities in Taiwan, Thailand, the Philippines and other foreign countries, and maintenance of substantially all of its finished goods in inventory overseas, entails certain political and economic risks, including political instability and expropriation, supply disruption, currency controls and exchange fluctuations, as well as changes in tax laws, tariff and freight rates. Microchip currently employs the Alphatec Electronics Public Company Limited group of companies ("Alphatec") headquartered in Bangkok, Thailand for a significant portion of its product assembly volume. While Alphatec's assembly operations have performed reliably for the Company for several years, Alphatec has experienced financing issues in connection with some of its joint ventures involving semiconductor fabrication facilities in Thailand. Such financing difficulties have not impacted Alphatec's assembly facilities nor its provision of services to the Company. However, there can be no assurance that assembly operations will not be affected in the future. Microchip currently has second sources for product assembly for most of its package types and can shift additional wafer output to other factories, if necessary. However, there can be no assurance that such action would not result in short-term disruption including possible temporary product shortages. The Company has not experienced any significant interruptions in its foreign business operations to date. Nonetheless, the Company's business and operating results could be adversely affected if foreign operations or international air transportation were disrupted.

Due to the high fixed cost inherent in semiconductor manufacturing, increased manufacturing yields can have significant positive effects on gross profits and overall operating results. During fiscal 1998, the Company continued to focus on manufacturing productivity, and maintained average wafer fab line yields in excess of 90%. The yields are primarily driven by a comprehensive implementation of statistical process control, extensive employee training and selective upgrading of the Company's manufacturing facilities and equipment. Maintenance of manufacturing productivity and yields are important factors in the achievement of the Company's operating results. As is typical in the semiconductor industry, the Company has from time to time experienced lower than anticipated manufacturing yields. The Company's operating results would be adversely affected if it were unable to maintain yields at approximately the current levels.

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The raw materials and equipment used in the production of the Company's integrated circuits currently are available from a number of suppliers, and the Company is not materially dependent on any single source of supply. Although the Company has not experienced any material difficulty to date in obtaining raw materials or equipment, the interruption of certain components or ingredients of certain raw materials could reduce the availability or increase the cost of raw materials used by the Company. The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those produced by the Company, is a highly complex process and 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 the fabrication equipment.

Research and Development

The Company's current research and development activities focus on the design of new microcontroller and memory products, ASSPs, new development systems, and software and application-specific software libraries. The Company is also developing new design and process technology to achieve further cost reductions and performance improvements in existing products. As of April 26, 1998, 277 employees were engaged in research and development. In fiscal 1998, 1997 and 1996, the Company's research and development expenses were \$38.4 million, \$32.1 million and \$27.5 million, respectively. The Company expects that it will continue to spend substantial funds on research and development activities.

The Company's future operating results will depend to a significant extent on its ability to continue to develop and introduce new products on a timely basis which compete effectively on the basis of price and performance and which address customer requirements. If the Company were unable to design, develop and introduce competitive products on a timely basis, its future operating results would be adversely affected.

Sales and Distribution

The Company markets its products worldwide through a direct sales organization and through distributors. In fiscal 1998, the Company derived approximately 47% of its net sales from direct sales to OEM customers and 53% from sales through distributors.

The Company's direct sales force, currently consisting of 166 people, focuses on three geographical markets: the Americas, Europe and Asia. In the Americas, the Company currently has Technical Support Centers in San Jose, Los Angeles, Dallas, Dayton, Chicago, Atlanta, Boston, New York and Toronto. Microchip also maintains Technical Support Centers in Tokyo, London, Munich, Paris, Milan, Taipei, Seoul, Singapore, Hong Kong, Shanghai, and Bangalore, India. Microchip's direct sales force is augmented by a worldwide network of national distributors and regional distributors in North and South America. Microchip's distribution effort also includes a network of manufacturer's representatives in North America and Europe.

Microchip believes that a strong technical service presence is essential to the continued development of the embedded control market. The majority of Microchip's field sales engineers (FSEs), field application engineers (FAEs) and sales management have technical degrees and have been previously employed in an engineering environment. The Company believes the technical knowledge of its sales force is a key competitive advantage in the sale of field programmable products. Currently, Microchip has at least one dedicated application engineer in every Technical Support Center. The primary mission of the FAE team is to provide technical assistance to OEM customers and to conduct periodic training sessions for FSEs, manufacturer's representatives and distributor sales teams. The FAEs also conduct frequent technical seminars in major cities around the world. FAEs also work closely with the Company's distributors and manufacturer's representatives to provide technical assistance in end-user support and to assist in the sales process.

As is common in the semiconductor industry, the Company grants price protection to distributors. Under this policy, distributors receive a credit for the difference, at the time of a price reduction, between the price they were originally charged for products in inventory and the reduced price which the Company subsequently charges distributors. From time to time, distributors also receive credit on an individual basis for Company-approved price reductions on specific transactions. The Company also grants some distributors limited rights to return products. The Company defers recognition of net sales and profit on sales to distributors that have rights of return and price protection until those distributors have resold the products to end-customers.

Foreign sales, primarily in Asia and Europe, represented approximately 68%, 66% and 65% of consolidated net sales in fiscal years 1998, 1997 and 1996, respectively. International sales are predominately billed in U.S. Dollars. Although

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foreign sales are subject to certain government export restrictions, the Company has not experienced any material difficulties as a result of export restrictions to date.

The Company's policy is to hedge its net foreign currency positions in the normal course of business to reduce its exposure to fluctuations in foreign exchange rates. Foreign exchange gains and losses were not material during fiscal years 1996 through 1998.

Backlog

As of April 26, 1998, the Company's backlog was approximately \$76.7 million as compared to \$93.7 million as of April 27, 1997. The Company includes in its backlog all purchase orders scheduled for delivery within the subsequent 12 months.

Microchip produces standard products that can be shipped from inventory within a short time after receipt of an order. The Company's business and, to a large extent, that of the entire semiconductor industry is characterized by short-term orders and shipment schedules. Orders constituting the Company's current backlog are subject to changes in delivery schedules or to cancellation at the option of the purchaser without significant penalty. Accordingly, although useful for scheduling production, backlog as of any particular date may not be a reliable measure of sales for any future period. Turns orders (orders received in a quarter for shipment in that quarter) have become an increasingly important component of the Company's quarterly operating results. See "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations - Net Sales," below.

Competition

The semiconductor industry is intensely competitive and has been characterized by price erosion, rapid technological change and foreign competition with respect to many products. The Company competes 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 the Company 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. The Company's overall average selling prices for its microcontroller products have remained relatively constant, while average selling prices of its memory products have declined over time. The Company expects to continue to experience increased pricing competition and declining prices for memory products. While average selling prices for microcontrollers have remained relatively constant, the Company has experienced, and expects to continue to experience, increasing pricing pressure in certain microcontroller product lines, due primarily to competitive conditions. The Company has been able to maintain average selling prices by continuing to introduce new products with more features and higher prices, thereby offsetting price declines in older products. There can be no assurance that average selling prices for the Company's microcontroller or other products can be maintained due to increased pricing pressure in the future. An increase in pricing pressure could adversely affect the Company's operating results. In addition, the Company's ability to compete successfully depends on a number of factors both within and outside its control, including the quality, performance, reliability, features, ease of use, pricing and diversity of its products; the quality of its customer service and its ability to address the needs of its customers; its success in designing and manufacturing new products including those implementing new technologies; efficiency of production, adequate sources of raw materials and other supplies at acceptable prices; protection of the Company's products and processes by effective utilization of intellectual property laws; the rate at which customers incorporate the Company's products into their own products; product introductions by the Company's competitors; the number, nature and success of its competitors in a given market; and general market and economic conditions. Furthermore, capacity in the semiconductor industry is increasing over time and such increased capacity or improved product availability could adversely affect the Company's competitive position.

The Company currently competes principally on the basis of the technical innovation and performance of its embedded control products, including their speed, functionality, density, power consumption, reliability and packaging alternatives, as well as on price and product availability. The Company believes that other important competitive factors in the embedded control market include ease of use, functionality of application development systems and technical service and support. The Company believes that it competes favorably with other companies on all of these factors, although there is no assurance that the Company will continue to be able to compete successfully in the future.

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Patents, Licenses and Trademarks

The Company's success depends in part on its ability to obtain patents, licenses and other intellectual property rights covering its products and manufacturing processes, and to protect its proprietary information. As of March 31, 1998, the Company owned 60 U.S. patents and 11 foreign patents, expiring on various dates between 1997 and 2015, and had an additional 78 U.S. patent applications and 55 foreign patent applications pending. The Company intends to continue to seek patents on its inventions used in its products and manufacturing processes. However, the Company believes that its continued success depends primarily on such factors as the technological skills and innovative abilities of its personnel rather than on its patents. There can be no assurance the Company's existing patents or any new patents that are issued will be of sufficient scope or strength to provide meaningful protection or other commercial advantage to the Company.

The Company has entered into certain intellectual property licenses and cross-licenses with other companies related to semiconductor products and manufacturing processes. As is typical in the semiconductor industry, the Company has from time to time received, and may in the future receive, communications alleging possible infringement of patents or other intellectual property rights of others. The Company investigates all such notices and responds as it believes is appropriate. The Company is currently in discussions with several other companies regarding intellectual property licenses of such other companies' semiconductor patents and technology. Based on industry practice, the Company believes that in most cases it could obtain any necessary licenses or other rights on commercially reasonable terms. However, no assurance can be given that licenses would be on acceptable terms, that litigation would not ensue, that damages for any past infringement would not be assessed or that the Company would not be forced to pay royalties on future sales. Litigation, which could result in substantial cost to the Company and diversion of management effort, may be necessary to enforce patents or other intellectual property rights of the Company or to defend the Company against claimed infringement of the rights of others. See "Item 3 - Legal Proceedings."

Environmental Regulation

The Company is subject to a variety of federal, state and local governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in its manufacturing processes, including the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act, the Superfund Amendment and Reauthorization Act, the Clean Air Act and the Water Pollution Control Act. The Company believes it has obtained all necessary environmental permits to conduct its business. Although the Company believes that its activities conform to presently applicable environmental regulations, the failure to comply with present or future regulations could result in fines being imposed on the Company, suspension of production or a cessation of operations. While the Company has not experienced any materially adverse effects on its operations from governmental regulations, there can be no assurance that changes in such regulations will not require the Company to acquire costly equipment or to incur other significant expenses to comply with environmental regulations. Any failure by the Company to control the use of or adequately restrict the discharge of hazardous substances could subject it to future liabilities. There can be no assurance that environmental problems will not occur in the future which could subject the Company to future costs or liabilities.

Employees

As of April 26, 1998, the Company had 2,153 employees, including 1,555 in manufacturing, 277 in research and development, 196 in sales and marketing and 125 in finance and administration. Approximately 41% of the Company's employees work at the final test facilities located in Kaohsiung, Taiwan and Chachoengsao, Thailand. No employees in the U.S. or Thailand are represented by a labor organization. All employees in the Kaohsiung facility, except for certain management employees, are represented by a labor organization. The Company has never had a work stoppage and believes that its employee relations are good.

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Executive Officers

The following sets forth certain information regarding the Company's executive officers as of April 26, 1998:

<TABLE>

<CAPTION>

| Name | Age | Position |
|-----------------------|-----|--------------------------------------------------------------|
| ---- | --- | ----- |
| <S> | <C> | <C> |
| Steve Sanghi | 42 | Chairman of the Board, President and Chief Executive Officer |
| Timothy B. Billington | 55 | Vice President, Manufacturing Operations |
| C. Philip Chapman | 44 | Vice President, Chief Financial Officer and Secretary |
| George P. Rigg | 58 | Vice President, Advanced Microcontroller and Systems Group |
| Mitchell R. Little | 45 | Vice President, Americas Sales |

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Mr. Sanghi is currently, and has been since August, 1990, President of the Company, since October, 1991, Chief Executive Officer and since October, 1993, Chairman of the Board of Directors. He has served as a director of the Company since August, 1990. He served as the Company's Chief Operating Officer from August, 1990 through October, 1991 and as Senior Vice President of Operations from February, 1990 through August, 1990. Mr. Sanghi holds an M.S. degree in Electrical and Computer Engineering from the University of Massachusetts and a B.S. degree in Electronics and Communication from Punjab University, India. Mr. Sanghi is also a director of ADFlex Solutions, Inc., a U.S. supplier of flexible circuit-based interconnect solutions.

Mr. Billington has served as Vice President, Manufacturing Operations since October, 1994 and was Vice President, Process Development and Manufacturing Operations from April, 1991 until October, 1994. Prior to his appointment as Vice President, Mr. Billington served as Director of Wafer Fabrication from November, 1990 to April, 1991 and Wafer Fabrication Manager from June, 1989 to November, 1990. Mr. Billington holds a B.S. degree in marketing from Abilene Christian University.

Mr. Chapman has served as the Company's Vice President and Chief Financial Officer since joining the Company in September, 1992 and as Secretary of the Company since December, 1992. Mr. Chapman holds an M.B.A. from the Harvard Graduate School of Business Administration and B.A. degrees in Accounting and Managerial Finance from the University of California.

Mr. Rigg has served as Vice President, Advanced Microcontroller and Systems Group since March, 1997. From November, 1995 to March, 1997 he served as Vice President, Advanced Microcontroller and Technology Division. From June, 1989 to November, 1995, he served as Vice President, Logic Products Division. Mr. Rigg holds a B.S. degree in Physics from Manchester University, England.

Mr. Little has served as Vice President, Americas Sales since April, 1998. From November, 1995 to April, 1998 he served as Vice President, Standard Microcontroller and ASSP Division. From September, 1993 to November, 1995, he served as Vice President, Memory Products and ASSP Division. Prior to his appointment as Vice President, Mr. Little served as Division Director for the

Company's Memory Products Division from July, 1991 to September, 1993, and as Director of Memory Marketing from November, 1989 to July, 1991. Mr. Little holds a BSET from United Electronics Institute.

Item 2. PROPERTIES

The Company's current headquarters, research and development center and one of its U.S wafer fabrication facilities are located in three buildings totaling approximately 242,000 square feet situated on a 77-acre parcel of land in Chandler, Arizona. A second U.S. manufacturing site consisting of a wafer fabrication facility, office and warehouse facilities and a development systems center, totaling approximately 253,000 square feet, is situated on a 22-acre parcel of land in Tempe, Arizona. The Chandler and Tempe facilities are owned by the Company. Company-owned final test facilities are located in Taiwan and Thailand. The Taiwan operations are housed in a three-story, 88,700 square foot building located in the Kaohsiung Export Processing Zone in Kaohsiung, Taiwan, Republic of China. The Taiwan building is owned by the Company's Taiwan subsidiary and is located on land that is leased to the Company pursuant to leases from the Taiwan government expiring in December, 1998 and 2002. The Company intends to renew the lease that expires in December, 1998. The Company's Thailand final test operations are housed in a 150,000 square foot facility located in the Alphatechnopolis Industrial Park in Chachoengsao, Thailand, near Bangkok. The Thailand facility, owned by the Company's Thailand subsidiary, is situated on land to which the Company expects to acquire title by the end of fiscal 1999, in accordance with an agreement between the Company and the land owner. The Company leases space for 20 Technical Support Centers in San Jose and Los Angeles, California; Dallas, Texas; Dayton, Ohio; Chicago, Illinois; Atlanta, Georgia; Boston, Massachusetts; New York, New York; as well as Toronto, Tokyo, London, Munich, Paris, Milan, Taipei, Seoul, Singapore, Hong Kong, Shanghai and Bangalore, India. The Company's aggregate monthly rental payments for its facilities are approximately \$107,000.

The Company currently believes that its existing facilities will be adequate to meet its requirements for the next 12 months.

Item 3. LEGAL PROCEEDINGS

In the ordinary course of its business, the Company is involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. Although the outcome of these actions is not presently determinable, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on the Company's results of operations or financial conditions. The Company could also be subject to future litigation if it is unable to resolve pending intellectual property and technology licensing discussions. The Company is currently the defendant in one case regarding intellectual property and has commenced litigation against other companies for alleged infringement of the Company's intellectual property rights. The Company does not expect these matters will have a material adverse effect on its business or results of operation. However, the failure to obtain necessary licenses or other rights, or litigation arising out of infringement claims, could have a material adverse effect on the Company's business and results of operations. Litigation relating to the semiconductor industry is not uncommon, and the Company is, and from time to time, has been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

The Securities and Exchange Commission is presently conducting an investigation into matters relating to the Company's disclosure on February 26, 1996 that revenues and earnings for the quarter ended March 31, 1996 would be lower than previously estimated. While the outcome of the investigation, and its effect on the Company, if any, cannot be predicted at the present time, the Company does not believe that the investigation will result in a material adverse effect on the Company.

Microchip Technology Incorporated v. Lucent Technologies Inc. (District of Arizona, CIV97-1502 PHX EHC) On January 13, 1998, the Company finalized a settlement in its patent litigation with Lucent Technologies Inc. and the case was dismissed on January 30, 1998. In connection with this settlement, the Company recorded a \$5 million charge during the quarter ended December 31, 1997. See "Item 5 - Market For Registrant's Common Equity and Related Stockholder Matters," below, and Note 2 to the Consolidated Financial Statements.

Item 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's security holders during the fourth quarter of fiscal 1998.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the Nasdaq National Market under the symbol "MCHP." The Company's Common Stock has been quoted on the Nasdaq National Market since March 19, 1993. The following table sets forth the quarterly high and low closing prices of the Common Stock as reported by the

Nasdaq National Market for the last two years, adjusted to reflect a 3-for-2 stock split effected in January, 1997:

<TABLE>

<CAPTION>

| Fiscal 1998 ----- | High ---- | Low --- | Fiscal 1997 ----- | High ---- | Low --- |
|----------------------|--------------|------------|----------------------|--------------|------------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| First Quarter | \$36.25 | \$29.00 | First Quarter | \$19.50 | \$14.67 |
| Second Quarter | 48.88 | 29.88 | Second Quarter | 25.67 | 14.00 |
| Third Quarter | 48.38 | 26.94 | Third Quarter | 34.84 | 23.34 |
| Fourth Quarter | 31.88 | 21.00 | Fourth Quarter | 39.50 | 25.00 |

</TABLE>

On May 22, 1998, the closing sale price for the Company's Common Stock was \$27.125 per share. As of such date, there were approximately 515 holders of record of the Company's Common Stock. This figure does not reflect beneficial ownership of shares held in nominee names.

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The Company has not paid cash dividends on its capital stock. The Company currently anticipates that it will retain all available funds for use in the operations of its business and therefore does not anticipate paying any cash dividends in the foreseeable future.

The trading price of the Company's Common Stock has been, and in the future could be, subject to wide fluctuations in response to quarterly variations in operating results of the Company and other semiconductor companies, actual or anticipated announcements of technical innovations or new products by the Company or its competitors, changes in analysts' estimates of the Company's financial performance, general conditions in the semiconductor industry, worldwide economic and financial conditions and other events or factors. In addition, the stock market has experienced significant price and volume fluctuations which have particularly affected the market prices for many high technology companies and which often have been unrelated to the operating performance of such companies. These broad market fluctuations and other factors may adversely affect the market price of the Company's Common Stock.

As of January 13, 1998 and in connection with the settlement of patent infringement litigation, the Company issued a warrant to acquire 300,000 shares of Common Stock at \$25.25 per share. The warrant is currently fully exercisable and expires on June 30, 2001. The issuance of the warrant was deemed exempt from registration under the Securities Act of 1933, as amended, in reliance on Section 4(2) of such Act. See "Item 3, Legal Proceedings," above and Note 2 to the Consolidated Financial Statements.

Item 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data for the five-year period ended March 31, 1998 should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 of this report. The Company's consolidated income statement data for each of the years in the three year period ended March 31, 1998, and the balance sheet data as of March 31, 1998 and 1997, are derived from the audited consolidated financial statements of the Company, included in Item 8 of this report.

<TABLE>

<CAPTION>

| | Year Ended March 31, | | | | |
|---------------------------------------|----------------------|------------|------------|------------|------------|
| | 1998 | 1997 | 1996 | 1995 | 1994 |
| | ----- | | | | |
| (in thousands, except per share data) | | | | | |
| Income Statement Data: | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Net sales | \$ 396,894 | \$ 334,252 | \$ 285,888 | \$ 207,961 | \$ 138,742 |
| Cost of sales | 199,538 | 167,330 | 137,708 | 101,039 | 73,765 |
| Research and development | 38,362 | 32,073 | 27,517 | 20,746 | 13,840 |
| Selling, general and administrative . | 67,549 | 56,248 | 48,903 | 36,975 | 26,933 |
| Special charges | 5,000 | 7,544 | 11,448 | -- | -- |
| Operating income | 86,445 | 71,057 | 60,312 | 49,201 | 24,204 |
| Interest income (expense), net | 1,505 | (1,852) | (947) | (881) | (593) |
| Other income, net | 217 | 288 | 569 | 808 | 522 |
| Income before income taxes | 88,167 | 69,493 | 59,934 | 49,128 | 24,133 |
| Provision for income taxes | 23,799 | 18,361 | 16,182 | 12,829 | 4,974 |
| Net income | \$ 64,368 | \$ 51,132 | \$ 43,752 | \$ 36,299 | \$ 19,159 |
| Basic net income per share | \$ 1.21 | \$ 0.99 | \$ 0.86 | \$ 0.76 | \$ 0.44 |
| Diluted net income per share | \$ 1.14 | \$ 0.94 | \$ 0.80 | \$ 0.70 | \$ 0.42 |
| Basic common shares outstanding | 53,376 | 51,569 | 50,750 | 47,525 | 43,446 |
| Diluted common shares outstanding ... | 56,313 | 54,683 | 54,533 | 51,641 | 46,155 |

<CAPTION>

| | As of March 31, | | | | |
|-----------------------|-----------------|-----------|-----------|-----------|-----------|
| | 1998 | 1997 | 1996 | 1995 | 1994 |
| | ----- | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Balance Sheet Data: | | | | | |
| Working capital | \$ 55,171 | \$ 91,176 | \$ 55,855 | \$ 71,307 | \$ 53,584 |
| Total assets | 524,743 | 428,092 | 358,187 | 249,480 | 151,425 |

| | | | | | |
|---------------------------------------------------|---------|---------|---------|---------|--------|
| Long-term obligations, less current portion | 8,768 | 5,999 | 33,250 | 15,340 | 14,424 |
| Stockholders' equity | 367,308 | 316,584 | 219,632 | 161,825 | 87,864 |

</TABLE>

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Item 7. 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 years indicated:

| | Year Ended March 31, | | |
|-------------------------------------|----------------------|--------|--------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| Net sales | 100.0% | 100.0% | 100.0% |
| Cost of sales | 50.3% | 50.1% | 48.2% |
| | ---- | ---- | ---- |
| Gross profit | 49.7% | 49.9% | 51.8% |
| Research and development | 9.7% | 9.6% | 9.6% |
| Selling, general and administrative | 17.0% | 16.8% | 17.0% |
| Special charges | 1.2% | 2.2% | 4.0% |
| | ---- | ---- | ---- |
| Operating income | 21.8% | 21.3% | 21.1% |
| | ==== | ==== | ==== |

Net Sales

Microchip's net sales of \$396.9 million in fiscal 1998 increased by \$62.6 million, or 18.7%, over fiscal 1997 and net sales of \$334.3 million in fiscal 1997 increased by \$48.4 million, or 16.9%, over fiscal 1996.

The Company's family of 8-bit microcontrollers represents the largest component of Microchip's total net sales. Microcontrollers and associated application development systems accounted for 66%, 64% and 59% of total net sales in fiscal 1998, 1997 and 1996, respectively. A related component of the Company's product sales consists primarily of Serial EEPROM memories which accounted for 34%, 36% and 41% of net sales in fiscal 1998, 1997 and 1996, respectively.

The Company's net sales in any given quarter are dependent upon a combination of orders received in that quarter for shipment in that quarter ("turns orders") and shipments from backlog. The Company has emphasized its ability to respond quickly to customer orders as part of its competitive strategy. This strategy, combined with current industry conditions, results in customers placing orders with short delivery schedules. The Company experienced increasing turns orders as a portion of the Company's business in fiscal 1998, as compared to fiscal 1997, which reduced the Company's visibility in projecting net sales levels. Because turns orders are difficult to predict, there can be no assurance that the combination of turns orders and shipments from backlog in any quarter will be sufficient to achieve growth in net sales. If the Company does not achieve a sufficient level of turns orders in a particular quarter, the Company's revenues and operating results would be adversely affected.

The Company's overall average selling prices for its microcontroller products have remained relatively constant, while average selling prices of its memory products have declined over time. During fiscal 1998, the Company continued to experience increased pricing pressure on its memory products primarily due to the less proprietary nature of these products and increased competition, and expects this to continue in the future. While average selling prices for microcontrollers have remained relatively constant, the Company has experienced, and expects to continue to experience, increasing pricing pressure in certain microcontroller product lines, due primarily to competitive conditions. The Company has been able to maintain average selling prices by continuing to introduce new products with more features and higher prices, thereby offsetting price declines in older products. There can be no assurance that average selling prices for the Company's microcontroller or other products can be maintained due to increased pricing pressure in the future. An increase in pricing pressure could adversely affect the Company's operating results.

The foregoing statements regarding turns orders, average selling prices and pricing pressures are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbors created thereby. 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; inventory, mix and timing of customer orders; competition and competitive pressures on pricing and product availability; customers' inventory levels, order patterns and seasonality; the cyclical nature of both the semiconductor industry and the markets addressed by the Company's products; market acceptance of the products of both the Company and

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its customers; demand for the Company's products, 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.

Several Asian countries have recently experienced economic difficulties including high rates of loan defaults, business failures and currency devaluations. During the quarters ended December 31, 1997 and March 31, 1998, the Company experienced weakness in the expected level of turns orders and net sales related to its business in Asia. During the fourth fiscal quarter of fiscal 1998, shipments to Asia were lower than the preceding quarter by approximately 30%. The Company derives a substantial portion of its net sales from customers in Asia and there can be no assurance that such economic difficulties will not continue to adversely affect the Company's operating results in future periods.

Foreign sales represented 68%, 66% and 65% of net sales in fiscal 1998, 1997 and 1996, respectively. The Company's foreign sales have been predominantly in Asia and Europe which the Company attributes to the manufacturing strength in those areas for consumer, automotive, office automation, communications and industrial products. The majority of foreign sales are U.S. Dollar denominated. The Company has entered into and, from time to time, will enter into hedging transactions in order to minimize exposure to currency rate fluctuations. Although none of the countries in which the Company conducts 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 the Company conducts operations will not adversely affect the Company's operating results in the future.

Additional Factors Affecting Operating Results

The Company believes that future growth in net sales of its 8-bit family of microcontroller products and related memory products will depend largely upon the Company's success in having its current and new products designed into high-volume customer applications. Design wins typically precede the Company's volume shipment of products for such applications by 15 months or more. The Company also believes that shipment levels of its proprietary application development systems are an indicator of potential future design wins and microcontroller sales. The Company continued to achieve a high volume of design wins and shipped increased numbers of application development systems in fiscal 1998 compared to previous fiscal years. There can be no assurance that any particular development system shipment will result in a product design win or that any particular design win will result in future product sales.

The Company's operating results are affected by a wide variety of other factors that could adversely impact its net sales and profitability, many of which are beyond the Company's control. These factors include the Company's ability to design and introduce new products on a timely basis, market acceptance of products of both the Company and its customers, customer order patterns and seasonality, changes in product mix, whether the Company's customers buy from a distributor or directly from the Company, product performance and reliability, product obsolescence, the amount of any product returns, availability and utilization of manufacturing capacity, fluctuations in manufacturing yield, the availability and cost of raw materials, equipment and other supplies, the cyclical nature of both the semiconductor industry and the markets addressed by the Company's products, technological changes, competition and competitive pressures on prices, and economic, political or other conditions in the United States, and other worldwide markets served by the Company. The Company believes its ability to continue to increase its manufacturing capacity to meet customer demand and maintain satisfactory delivery schedules will be an important competitive factor. As a result of the increase in fixed costs and operating expenses related to expanding its manufacturing capacity, the Company's operating results may be adversely affected if net sales do not increase sufficiently to offset the increased costs. The Company's products are incorporated into a wide variety of consumer, automotive, office automation, communications and industrial products. A slowdown in demand for products which utilize the Company's products as a result of economic or other conditions in the worldwide markets served by the Company could adversely affect the Company's operating results.

Gross Profit

The Company's gross profit was \$197.3 million, \$166.9 million and \$148.2 million in fiscal 1998, 1997 and 1996, respectively. Gross profit as a percent of sales was 49.7%, 49.9% and 51.8% in fiscal 1998, 1997 and 1996, respectively. The gross profit percentage in fiscal years 1998 and 1997 was down from the fiscal 1996 level, primarily as a result of reduced 5-inch wafer production at one of the Company's wafer fabrication facilities and increased pricing pressure on its non-volatile memory products. The Company is continuing the process of transitioning products to smaller geometries and to larger wafer sizes to reduce future manufacturing costs. Eight-inch wafer production commenced at the Tempe wafer fabrication facility in early fiscal 1998 and the Company is continuing the transitioning of products to its 0.7 micron process. The Company expects that 25% of its products will come from 8-inch wafers during fiscal 1999. The Company

anticipates that its cost of sales and gross product margins will fluctuate over time, driven primarily by the product mix of 8-bit microcontroller products and related memory products, manufacturing yields, wafer fab loading levels and competitive and economic conditions.

The foregoing statements relating to anticipated gross margins, cost of sales, 8-inch wafer production, and the transition to higher yielding manufacturing processes are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbors created thereby. Actual results could differ materially because of the following factors, among others: fluctuations in production yields, production efficiencies and overall capacity utilization; cost and availability of raw materials; absorption of fixed costs, labor and other direct manufacturing costs; the timing and success of manufacturing process transition; changes in product mix; competitive pressures on prices; and other economic conditions.

In the quarter ended June 30, 1997, the Company changed its method of accounting for inventories from the last-in, first-out (LIFO) method to the first-in, first-out (FIFO) method. The change did not have a material effect on the results of operations. The FIFO method is the predominant accounting method used in the semiconductor industry. Prior to this change, the Company's inventory costs did not differ significantly under the two methods. Prior period results of operations have not been restated for this change as the impact is not material.

All of Microchip's assembly operations are performed by third-party contractors in order to meet product shipment requirements. Reliance on third parties involves some reduction in the Company's level of control over these portions of its business. While the Company reviews the quality, delivery and cost performance of these third-party contractors, there can be no assurance that reliance on third-party contractors will not adversely impact results in future reporting periods if any third-party contractor is unable to maintain assembly yields and costs at approximately their current levels.

The Company's reliance on facilities in Taiwan, Thailand, the Philippines and other foreign countries, and maintenance of substantially all of its finished goods in inventory overseas, entails certain political and economic risks, including political instability and expropriation, supply disruption, currency controls and exchange fluctuations, as well as changes in tax laws, tariff and freight rates. Microchip currently employs the Alphatec Electronics Public Company Limited group of companies ("Alphatec") headquartered in Bangkok, Thailand for a significant portion of its product assembly volume. While Alphatec's assembly operations have performed reliably for the Company for several years, Alphatec has experienced financing issues in connection with some of its joint ventures involving semiconductor fabrication facilities in Thailand. Such financing difficulties have not impacted Alphatec's assembly facilities nor its provision of services to the Company. However, there can be no assurance that assembly operations will not be affected in the future. Microchip currently has second sources for product assembly for most of its package types and can shift additional wafer output to other factories, if necessary. However, there can be no assurance that such action would not result in short-term disruption including possible temporary product shortages. The Company has not experienced any significant interruptions in its foreign business operations to date. Nonetheless, the Company's business and operating results could be adversely affected if foreign operations or international air transportation were disrupted.

Research and Development

The Company is committed to continued investment in new and enhanced products, including its development systems software and in its design and manufacturing process technology, which are significant factors in maintaining the Company's competitive position. The dollar investment in research and development increased 20% in fiscal 1998 over fiscal 1997, and 17% in fiscal 1997 over fiscal 1996. The Company will continue to invest in research and development in the future, including an investment in process and product development associated with the capacity expansion of the Company's fabrication facilities.

The Company's future operating results will depend to a significant extent on its ability to continue 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 customers' end products. Because of the complexity of its products, the Company has experienced delays from time to time in completing development of new products. In addition, there can be no assurance that any new products will receive or maintain substantial market acceptance. If the Company were unable to design, develop and introduce competitive products on a timely basis, its future operating results would be adversely affected.

The Company's future success will also depend upon its ability to develop and implement new design and process technologies. Semiconductor design and process technologies are subject to rapid technological change, requiring large expenditures for research and development. Other companies in the industry have experienced difficulty in effecting transitions to smaller geometry processes and to larger wafers and, consequently, have suffered reduced manufacturing yields or delays in product deliveries. The Company believes that its transition to smaller geometries and to larger wafers will be important for the Company to remain competitive, and operating results could be adversely affected if the transition is substantially delayed or inefficiently implemented.

Selling, General and Administrative

The Company increased its level of investment in selling, general and administrative costs to \$67.5 million, \$56.2 million and \$48.9 million for fiscal years 1998, 1997 and 1996, respectively. The increased costs reflect the requirement to invest in incremental worldwide sales and technical support resources to promote the Company's embedded control products.

Other Income (Expense)

Interest income in fiscal 1998 increased over fiscal 1997 and 1996 as a result of increased invested cash balances, resulting from completion of an equity offering in February, 1997. Interest expense in fiscal 1998 decreased over fiscal 1997 and 1996 due to reductions in borrowing levels associated with the Company's capital equipment additions. Other income represents numerous immaterial non-operating items. The Company's interest expense could increase in fiscal 1999 if the Company increases its borrowings and interest expense would be adversely impacted by increased interest rates.

Provision for Income Taxes

Provisions for income taxes reflect tax on foreign earnings and federal and state tax on U.S. earnings. The Company had an effective tax rate of 27.0%, 26.4% and 27.0% for the years ended March 31, 1998, 1997 and 1996, respectively, due primarily to lower tax rates at its foreign locations. The Company believes that its tax rate for the foreseeable future will be approximately 27%. The foregoing statement regarding the Company's anticipated future tax rate is a forward-looking statement within the meaning of section 27A of the Securities Act of 1933, as amended, and section 21E of the Securities Exchange Act of 1934, as amended, and is subject to the safe harbors created thereby. Actual results could differ materially because of the following factors, among others: current tax laws and regulations, taxation rates in geographic regions where the Company has significant operations; and current tax holidays available in foreign locations.

Year 2000 Conversion

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the year, thus rendering them incapable of properly managing and manipulating data that includes 21st century dates. The Company is currently installing business and financial systems to replace existing software systems to address the Year 2000 compliance issue. The Company is also currently reviewing other aspects of its computer systems, including manufacturing and product development areas. Microchip's products, for the most part, involve hardware integrated circuit devices manufactured by Microchip which, subsequent to their sale, are combined with proprietary application firmware by Microchip's customers. Thus, Microchip believes that its products have no inherent date sensitive features. At this time management is not able to assess the cost of Year 2000 compliance. The Company does not anticipate that the Year 2000 will pose significant operating problems. However, delays in the implementation of new information systems, or a failure to fully identify and resolve all Year 2000 deficiencies in the Company's systems could have a material adverse effect on the Company's future results of operations.

Liquidity and Capital Resources

The Company had \$32.2 million in cash and cash equivalents at March 31, 1998, a decrease of \$10.8 million from the March 31, 1997 balance. The Company has an unsecured line of credit with a syndicate of domestic banks totaling \$90.0 million. Borrowings under the domestic line of credit as of March 31, 1998 were \$7.0 million. The domestic line of credit requires the Company to achieve certain financial ratios and operating results. The Company was in compliance with these covenants at March 31, 1998. The Company also has an unsecured short term line of credit totaling \$19.8 million with certain foreign banks. Borrowings under the foreign line of credit as of March 31, 1998 were \$16.0 million. There are no covenants related to the foreign line of credit.

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At March 31, 1998, an aggregate of \$86.8 million of these facilities was available, subject to financial covenants and ratios with which the Company was in compliance. The Company's ability to fully utilize these facilities is dependent on the Company remaining in compliance with such covenants and ratios.

During the year ended March 31, 1998, the Company generated \$136.5 million of cash from operating activities, an improvement of \$59.0 million from the year

ended March 31, 1997 and an improvement of \$63.1 million from the year ended March 31, 1996. The improvement in cash flow from operations was primarily due to increased profitability, the impact of changes in accounts payable, accrued expenses and accounts receivable and an increase in depreciation expense.

The Company's level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the years ended March 31, 1998, 1997 and 1996 were \$145.3 million, \$79.0 million and \$115.8 million, respectively. Capital expenditures were primarily for the expansion of production capacity and the addition of research and development equipment in each of these periods. The Company currently intends to spend approximately \$55.0 million during the next 12 months for additional capital equipment to increase capacity at its existing wafer fabrication facilities and to expand product test operations. The Company expects capital expenditures will be financed by cash flow from operations, available debt arrangements and other sources of financing. The Company believes that the capital expenditures anticipated to be incurred over the next 12 months will provide sufficient additional manufacturing capacity to meet its currently anticipated needs.

Net cash used in financing activities was \$2.1 million for the year ended March 31, 1998. Net cash provided by financing activities was \$13.4 million and \$27.1 million for the years ended March 31, 1997 and 1996 respectively. Proceeds from sale of stock and put options were \$12.5 million, \$59.5 million and \$9.6 million for the years ended March 31, 1998, 1997 and 1996, respectively. Proceeds from issuance of long-term debt were \$2.9 million for the year ended March 31, 1996. Payments on long term debt and capital lease obligations were \$6.1 million, \$5.7 million and \$5.9 million for the years ended March 31, 1998, 1997 and 1996, respectively. Proceeds from lines of credit were \$23.0 million and \$20.5 million for the years ended March 31, 1998 and 1996 respectively. Repayments on lines of credit were \$21.0 million for the year ended March 31, 1997. Cash expended for the purchase of the Company's Common Stock was \$31.5 million and \$19.5 million for the years ended March 31, 1998 and 1997, respectively.

On January 30, 1998 and July 26, 1997, the Company's Board of Directors authorized the repurchase of 2,500,000 shares and 1,500,000 shares, respectively, in connection with a Common Stock repurchase plan. On July 26, 1997, the Board of Directors also authorized the Company to sell up to 750,000 put options in connection with the same plan. As of March 31, 1998 the Company has purchased 1,277,500 shares of Common Stock at an aggregate cost of \$31,481,000 and has outstanding 400,000 put options at prices ranging from \$29.63 to \$38.81. Subsequent to March 31, 1998 the Company purchased 222,500 shares of Common Stock at an aggregate price of \$6,667,000 and sold put options of 100,000 shares of Common Stock at a price of \$27.50.

Subsequent to March 31, 1998, the Company completed two transactions in connection with the stock repurchase program. April, 1998 the Company completed a costless collar transaction for 500,000 calls priced at \$25.95 and 665,000 puts priced at \$25.19. The expiration date of the transaction is April 23, 1999. Also in connection with the stock repurchase program, the Company completed a net share settled forward contract for 2,000,000 shares at an average price of \$29.24. The expiration date of this transaction is May, 2000 with quarterly interim settlement dates as determined by the Company.

Also subsequent to March 31, 1998 the Company's Board of Directors authorized an additional share repurchase of Common Stock of 2,000,000 shares and to sell up to 500,000 additional put options. The Company expects from time to time to purchase shares of Common Stock in connection with its authorized Common Stock repurchase plan.

The Company believes that its existing sources of liquidity combined with cash generated from operations will be sufficient to meet the Company's currently anticipated cash requirements for at least the next 12 months. However, the semiconductor industry is capital intensive. In order to remain competitive, the Company must continue to make significant investments in capital equipment, for both production and research and development. The Company may seek additional equity or debt financing during the next 12 months for the capital expenditures required to maintain or expand the Company's wafer fabrication and product test facilities or other purposes. The timing and amount of any such capital requirements will depend on a number of factors, including demand for the Company's products, product mix, changes in industry conditions 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 additional dilution to existing investors.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Consolidated Financial Statements of the Company listed in the index appearing under Item 14(a)(1) hereof are filed as part of this Annual Report on Form 10-K. See also Index to Financial Statements on page F- I hereof.

to this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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
(Registrant)

By: /s/ Steve Sanghi

Steve Sanghi
President and Chief Executive Officer

Date: May 26, 1998

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Name and Signature ----- | Title ----- | Date ----- |
|-----------------------------------------------------|----------------------------------------------------------------------------------------------------------|---------------|
| /s/ Steve Sanghi ----- Steve Sanghi | Director, President and Chief Executive Officer | May 26, 1998 |
| Albert J. Hugo-Martinez* | Director | May 26, 1998 |
| Jon H. Beedle* | Director | May 26, 1998 |
| L. B. Day* | Director | May 26, 1998 |
| Matthew W. Chapman* | Director | May 26, 1998 |
| /s/ C. Philip Chapman ----- C. Philip Chapman | Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer) | May 26, 1998 |
| *By: /s/ Steve Sanghi ----- Steve Sanghi | Individually and as Attorney-in-fact | May 26, 1998 |

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Annual Report on Form 10-K

Item 8, Item 14(a)(1) and (2), (c) and (d)

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CONSOLIDATED FINANCIAL STATEMENTS

EXHIBITS

YEAR ENDED MARCH 31, 1998

MICROCHIP TECHNOLOGY INCORPORATED
AND SUBSIDIARIES

CHANDLER, ARIZONA

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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for each of the years in the three-year

| | |
|---------------------------------------------------------------------------------------------------------------------------|-----|
| period ended March 31, 1998 | F-3 |
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| Consolidated Statements of Stockholders' Equity for each of the years in the three-year period ended March 31, 1998 | F-5 |
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| i | |
| KPMG Peat Marwick LLP | |

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Microchip Technology Incorporated:

We have audited the accompanying consolidated balance sheets of Microchip Technology Incorporated and subsidiaries as of March 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended March 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Microchip Technology Incorporated and subsidiaries as of March 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 1998, in conformity with generally accepted accounting principles.

/s/ KPMG Peat Marwick LLP

Phoenix, Arizona
April 22, 1998, except as to the
second and third paragraphs in
note 13 which are as of May 18, 1998

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands except share amounts)

<TABLE>
<CAPTION>

ASSETS

| | March 31, 1998 | March 31, 1997 |
|------------------------------------|-------------------|-------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Cash and cash equivalents | \$ 32,188 | \$ 42,999 |
| Accounts receivable, net | 56,320 | 61,102 |
| Inventories | 66,293 | 56,813 |
| Prepaid expenses | 2,208 | 1,715 |
| Deferred tax asset | 35,778 | 24,251 |
| Other current assets | 1,802 | 2,656 |
| | ----- | ----- |
| Total current assets | 194,589 | 189,536 |
| Property, plant and equipment, net | 325,892 | 234,058 |
| Other assets | 4,262 | 4,498 |

| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Total assets | \$ 524,743 | \$ 428,092 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Short-term lines of credit | \$ 16,000 | \$ -- |
| Accounts payable | 36,049 | 35,281 |
| Current maturities of long-term debt | 2,196 | 2,470 |
| Current maturities of capital lease obligations | 2,206 | 3,776 |
| Accrued liabilities | 53,452 | 36,392 |
| Deferred income on shipments to distributors | 29,515 | 20,441 |
| | ----- | ----- |
| Total current liabilities | 139,418 | 98,360 |
| Long-term lines of credit | 7,000 | -- |
| Long-term debt, less current maturities | 1,420 | 3,616 |
| Capital lease obligations, less current maturities | 348 | 2,383 |
| Long-term pension accrual | 976 | 980 |
| Deferred tax liability | 8,273 | 6,169 |
| Commitments and Contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding | -- | -- |
| Common stock, \$.001 par value; authorized 100,000,000 shares; issued 53,891,041 and outstanding 52,870,389 shares at March 31, 1998; issued 53,300,619 and outstanding 53,196,037 shares at March 31, 1997 | 54 | 53 |
| Additional paid-in capital | 176,865 | 168,185 |
| Retained earnings | 214,193 | 149,825 |
| Less shares of common stock held in treasury at cost; 1,020,652 shares at March 31, 1998 and 104,582 shares at March 31, 1997 | (23,804) | (1,479) |
| | ----- | ----- |
| Net stockholders' equity | 367,308 | 316,584 |
| Total liabilities and stockholders' equity | \$ 524,743 | \$ 428,092 |
| | ===== | ===== |

</TABLE>

See accompanying notes to consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)

| | Years Ended March 31, | | |
|-------------------------------------|-----------------------|------------|------------|
| | 1998 | 1997 | 1996 |
| | ----- | ----- | ----- |
| Net sales | \$ 396,894 | \$ 334,252 | \$ 285,888 |
| Cost of sales | 199,538 | 167,330 | 137,708 |
| | ----- | ----- | ----- |
| Gross profit | 197,356 | 166,922 | 148,180 |
| Operating expenses: | | | |
| Research and development | 38,362 | 32,073 | 27,517 |
| Selling, general and administrative | 67,549 | 56,248 | 48,903 |
| Special charges | 5,000 | 7,544 | 11,448 |
| | ----- | ----- | ----- |
| | 110,911 | 95,865 | 87,868 |
| Operating income | 86,445 | 71,057 | 60,312 |
| Other income (expense): | | | |
| Interest income | 2,635 | 1,419 | 2,034 |
| Interest expense | (1,130) | (3,271) | (2,981) |
| Other, net | 217 | 288 | 569 |
| | ----- | ----- | ----- |
| Income before income taxes | 88,167 | 69,493 | 59,934 |
| Income taxes | 23,799 | 18,361 | 16,182 |
| | ----- | ----- | ----- |
| Net income | \$ 64,368 | \$ 51,132 | \$ 43,752 |
| | ===== | ===== | ===== |
| Basic net income per share | \$ 1.21 | \$ 0.99 | \$ 0.86 |

| | | | |
|------------------------------------------------------------------|---------|---------|---------|
| | ===== | ===== | ===== |
| Diluted net income per share | \$ 1.14 | \$ 0.94 | \$ 0.80 |
| | ===== | ===== | ===== |
| Weighted average common shares outstanding | 53,376 | 51,569 | 50,750 |
| | ===== | ===== | ===== |
| Weighted average common and common equivalent shares outstanding | 56,313 | 54,683 | 54,533 |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

<TABLE>
<CAPTION>

| | Years Ended March 31, | | |
|-----------------------------------------------------------------------------------|-----------------------|-----------|-----------|
| | 1998 | 1997 | 1996 |
| | ---- | ---- | ---- |
| <S> | <C> | <C> | <C> |
| Cash flows from operating activities: | | | |
| Net income | \$ 64,368 | \$ 51,132 | \$ 43,752 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for doubtful accounts | 638 | 452 | 634 |
| Provision for inventory valuation | 2,126 | 1,886 | 7,639 |
| Provision for pension accrual | 1,202 | 1,316 | 1,197 |
| Special charges | 5,000 | 2,483 | -- |
| Depreciation and amortization | 53,468 | 39,853 | 29,975 |
| Amortization of purchased technology | 300 | 300 | -- |
| Deferred income taxes | (9,423) | (3,000) | (7,402) |
| Tax benefit from exercise of stock options | 5,332 | 5,742 | 4,130 |
| (Increase) decrease in accounts receivable | 4,144 | (14,346) | (9,974) |
| Increase in inventories | (11,606) | (2,572) | (23,565) |
| Increase (decrease) in accounts payable and accrued liabilities | 12,828 | (3,699) | 28,788 |
| Change in other assets and liabilities | 8,164 | (1,961) | (1,815) |
| | ----- | ----- | ----- |
| Net cash provided by operating activities | 136,541 | 77,586 | 73,359 |
| | ----- | ----- | ----- |
| Cash flows from investing activities: | | | |
| Capital expenditures | (145,301) | (79,012) | (115,845) |
| Sales of marketable securities | -- | -- | 13,796 |
| | ----- | ----- | ----- |
| Net cash used in investing activities | (145,301) | (79,012) | (102,049) |
| | ----- | ----- | ----- |
| Cash flows from financing activities: | | | |
| Net proceeds from (repayments on) lines of credit | 23,000 | (21,000) | 20,499 |
| Proceeds from issuance of long-term debt | -- | -- | 2,926 |
| Payments on long-term debt | (2,470) | (2,734) | (2,688) |
| Payments on capital lease obligations | (3,605) | (2,948) | (3,251) |
| Repurchase of common stock | (31,481) | (19,463) | -- |
| Proceeds from sale of stock and put options | 12,505 | 59,511 | 9,625 |
| | ----- | ----- | ----- |
| Net cash provided by (used in) financing activities | (2,051) | 13,366 | 27,111 |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | (10,811) | 11,940 | (1,579) |
| Cash and cash equivalents at beginning of year | 42,999 | 31,059 | 32,638 |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of year | \$ 32,188 | \$ 42,999 | \$ 31,059 |
| | ===== | ===== | ===== |

</TABLE>

See accompanying notes to consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

<TABLE>

<CAPTION>

| (in thousands) | Common Stock and Additional Paid-in Capital | | Common Stock held in Treasury | | Retained Earnings | Net Stockholders' Equity |
|----------------------------------------------------------------------------------------------------------------|---------------------------------------------------|------------|-------------------------------------|-------------|----------------------|--------------------------------|
| | Shares | Amount | Shares | Amount | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Balance March 31, 1995 | 49,955 | \$ 106,884 | -- | -- | \$ 54,941 | \$ 161,825 |
| Sale of Stock | | | | | | |
| Exercise of stock options | 1,368 | 5,686 | -- | -- | -- | 5,686 |
| Employee stock purchase plan | 258 | 3,292 | -- | -- | -- | 3,292 |
| Sale of put options | -- | 647 | -- | -- | -- | 647 |
| Tax benefit from exercise of options | -- | 4,130 | -- | -- | -- | 4,130 |
| Unrealized holding loss | -- | 240 | -- | -- | -- | 240 |
| Compensation expense | -- | 60 | -- | -- | -- | 60 |
| Net income | -- | -- | -- | -- | 43,752 | 43,752 |
| Balance March 31, 1996 | 51,581 | \$ 120,939 | -- | -- | \$ 98,693 | \$ 219,632 |
| Sale of Stock | | | | | | |
| Public offering (net of offering Costs of \$2,905) | 1,380 | 47,120 | -- | -- | -- | 47,120 |
| Exercise of stock options | 1,315 | 8,388 | -- | -- | -- | 8,388 |
| Employee stock purchase plan | 246 | 3,576 | -- | -- | -- | 3,576 |
| Purchase of treasury stock | -- | -- | 1,326 | (19,463) | -- | (19,463) |
| Issuance of treasury stock for the exercise of options and purchases in the employee stock purchase plan | (1,221) | (17,984) | (1,221) | 17,984 | -- | -- |
| Sale of put options, net | -- | 427 | -- | -- | -- | 427 |
| Tax benefit from exercise of options | -- | 5,742 | -- | -- | -- | 5,742 |
| Compensation expense | -- | 30 | -- | -- | -- | 30 |
| Net income | -- | -- | -- | -- | 51,132 | 51,132 |
| Balance March 31, 1997 | 53,301 | \$ 168,238 | 105 | \$ (1,479) | \$ 149,825 | \$ 316,584 |
| Sale of Stock | | | | | | |
| Exercise of stock options | 778 | 5,972 | -- | -- | -- | 5,972 |
| Employee stock purchase plan | 173 | 4,318 | -- | -- | -- | 4,318 |
| Purchase of treasury stock | -- | -- | 1,277 | (31,481) | -- | (31,481) |
| Issuance of treasury stock for the exercise of options and purchases in the employee stock purchase plan | (361) | (9,156) | (361) | 9,156 | -- | -- |
| Sale of put options, net | -- | 2,215 | -- | -- | -- | 2,215 |
| Tax benefit from exercise of options | -- | 5,332 | -- | -- | -- | 5,332 |
| Net income | -- | -- | -- | -- | 64,368 | 64,368 |
| Balance March 31, 1998 | 53,891 | \$ 176,919 | 1,021 | \$ (23,804) | \$ 214,193 | \$ 367,308 |

</TABLE>

See accompanying notes to consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Cash and Cash Equivalents

All highly liquid investments including marketable securities purchased with an original maturity of three months or less are considered to be cash equivalents. At March 31, 1997, the Company had classified marketable securities of \$25,964,000, with a maturity of less than three months as cash and cash equivalents. There were no marketable securities at March 31, 1998.

Inventories

Inventories are valued at the lower of cost or market using the

first-in, first-out (FIFO) method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Major renewals and improvements are capitalized, while maintenance and repairs are expensed when incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets which range from three to twenty-five years.

Assets acquired under capital lease arrangements have been recorded at the present value of the future minimum lease payments and are being amortized on a straight-line basis over the estimated useful life of the asset or the lease term, whichever is shorter. Amortization of this equipment is included in depreciation and amortization expense.

Foreign Currency Translation and Forward Contracts

The Company's foreign subsidiaries are considered to be extensions of the U.S. company and any translation gains and losses related to these subsidiaries are included in income. As the U.S. Dollar is utilized as the functional currency, gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the subsidiaries' functional currency) are also included in income. Gains and losses associated with currency rate changes on forward contracts are recorded currently in income.

Revenue Recognition

Revenue from product sales to direct customers is recognized upon shipment. The Company defers recognition of net sales and profits on sales to distributors that have rights of return and price protection until the distributors have resold the products.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled.

Computation of Net Income per Share

In 1997, the Financial Accounting Standards Board issued SFAS No. 128, Earnings per Share ("SFAS No. 128"). SFAS No. 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and where appropriate restated, to conform to the SFAS No. 128 requirements.

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Impairment of Long-Lived Assets

The Company records impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

Stock Option Plans

Prior to April 1, 1996, the Company accounted for its stock option plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense would be recorded, only if, on the date of grant, the current market price of the underlying stock exceeded the exercise price. On April 1, 1996, the Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, which permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in fiscal 1996 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123.

Use of Estimates

The Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Reclassifications

Certain 1997 and 1996 fiscal year balances have been reclassified to

conform to the fiscal year 1998 presentation.

2. SPECIAL CHARGES

Legal Settlement With Lucent Technologies Inc.

On January 13, 1998, the Company finalized a settlement of its patent litigation with Lucent Technologies Inc. resulting in the Company recording a \$5 million special charge during the quarter ended December 31, 1997. Under the terms of the settlement, Microchip made a one-time cash payment to Lucent and issued to Lucent warrants to acquire 300,000 shares of Common Stock of the Company priced at \$25.25 per share. The terms of the settlement also provide for the Company to make a contingent payment to Lucent if the Company's earnings per share performance for the three and one-half year period ending June 30, 2001 does not meet certain targeted levels. It is currently anticipated that any contingent payment required under the terms of the settlement would be expensed in the period the amount is determined.

Acquisitions

Keeloq(R) Hopping Code

On November 17, 1995, the Company acquired the Keeloq(R) hopping code technology and patents developed by Nanoteq Ltd. of the Republic of South Africa, and the marketing rights related thereto (the "Keeloq Acquisition"). The Keeloq Acquisition was treated as an asset purchase for accounting purposes. The amount paid for the Keeloq Acquisition, including all related costs, was \$12,948,000. The Company has written off a substantial portion of the purchase price that relates to in-process research and development costs, which is consistent with the Company's ongoing treatment of research and development costs, as well as all Keeloq Acquisition-related costs. The special charge associated with the Keeloq Acquisition was \$11,448,000, with the balance treated as purchased technology and amortized on a straight line basis over five years. Under the terms of the Keeloq Acquisition, the Company agreed to a secondary payment which will be determined by a formula based on the net sales and gross margin results of the division for the six month period ended December 31, 1998. Any such secondary payment is based on future performance and is currently not determinable. It is currently anticipated that any such payment would be expensed in the quarter the amount is determined. The impact of the Keeloq Acquisition to the Company's reported financial position and results of operations is immaterial, therefore, pro-forma information illustrating the combined results after the Keeloq Acquisition has not been provided.

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ASIC Technical Solutions

On June 25, 1996, the Company acquired ASIC Technical Solutions, Inc., a fabless provider of quick turn gate array devices (the "ASIC Acquisition"). The ASIC Acquisition was treated as a purchase for accounting purposes. The amount paid for the ASIC Acquisition and related costs was \$1,750,000. As part of the ASIC Acquisition, the Company allocated a substantial portion of the purchase price to in-process research and development costs, which is consistent with the Company's on-going treatment of research and development costs. The total special charge associated with the ASIC Acquisition was \$1,575,000, with the balance treated as purchased technology related to current products and amortized over five years. The impact of the ASIC Acquisition to the Company's reported financial position and results of operations is immaterial, therefore, pro-forma information illustrating the combined results after the ASIC Acquisition has not been provided.

Restructuring Charges

During the quarter ended June 30, 1996, primarily in response to inventory correction activities at the Company's customers, the Company implemented a series of actions to reduce production capacity, curtail the growth of inventories and reduce operating expenses. These actions included delaying capital expansion plans and deferring capital spending, a 15% production cutback in wafer fabrication, a headcount reduction in early April, 1996 representing approximately 3% of the Company's worldwide employees, and a two-week wafer fab shut down in early July, 1996. As a result of these actions, the Company recorded a pre-tax special charge of \$5,969,000 in the quarter ended June 30, 1996 to cover costs primarily related to idling part of the Company's 5-inch wafer fab capacity, paying continuing expenses during the wafer fabrication facility shutdown and paying severance costs associated with the April, 1996 headcount reduction.

3. CONTINGENCIES

The Company is subject to lawsuits and other claims arising in the ordinary course of its business. In the Company's opinion, based on consultation with legal counsel, as of March 31, 1998, the effect of such matters will not have a material adverse effect on the Company's

financial position.

4. ACCOUNTS RECEIVABLE

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

| | March 31, | |
|--------------------------------------|-----------|----------|
| | 1998 | 1997 |
| Trade accounts receivable | \$57,922 | \$62,165 |
| Other | 790 | 1,031 |
| | ----- | ----- |
| | 58,712 | 63,196 |
| Less allowance for doubtful accounts | 2,392 | 2,094 |
| | ----- | ----- |
| | \$56,320 | \$61,102 |
| | ===== | ===== |

5. INVENTORIES

The components of inventories are as follows (amounts in thousands):

| | March 31, | |
|----------------------------------------|-----------|----------|
| | 1998 | 1997 |
| Raw materials | \$ 5,795 | \$ 3,365 |
| Work in process | 40,000 | 44,813 |
| Finished goods | 30,021 | 16,966 |
| | ----- | ----- |
| | 75,816 | 65,144 |
| Less allowance for inventory valuation | 9,523 | 8,331 |
| | ----- | ----- |
| | \$66,293 | \$56,813 |
| | ===== | ===== |

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In the quarter ended June 30, 1997, the Company changed its method of accounting for inventories from the last-in, first-out (LIFO) method to the first-in, first-out (FIFO) method. The change did not have a material effect on the results of operations. The FIFO method is the predominant accounting method used in the semiconductor industry. Prior to this change, the Company's inventory costs did not differ significantly under the two methods. Prior period results of operations have not been restated for this change as the impact is not material.

6. PROPERTY, PLANT AND EQUIPMENT

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

| | March 31, | |
|---------------------------------------------------|-----------|-----------|
| | 1998 | 1997 |
| Land | \$ 11,749 | \$ 10,837 |
| Building and building improvements | 59,725 | 51,796 |
| Machinery and equipment | 322,624 | 218,284 |
| Projects in process | 82,528 | 52,608 |
| | ----- | ----- |
| | 476,626 | 333,525 |
| Less accumulated depreciation and amortization | 150,734 | 99,467 |
| | ----- | ----- |
| | \$325,892 | \$234,058 |
| | ===== | ===== |

7. LONG-TERM DEBT

Long-term debt consists of borrowings (denominated in U.S. Dollars) from three Taiwan financial institutions, secured by equipment financed thereby. Interest rates are at the Singapore Interbank Offering Rate (SIBOR) (5.69% at March 31, 1998) plus 0.75% and at the London Interbank Offering Rate (LIBOR) (5.69% at March 31, 1998) plus .75%. The weighted average interest rate on these borrowings was 5.89% at

March 31, 1998. Payments, including interest, are due semi-annually through September 15, 2000. The aggregate annual maturities of long term debt as of March 31, 1998 are \$2,196,000, \$1,147,000 and \$273,000 for the years ending March 31, 1999, 2000 and 2001, respectively.

The Company has an unsecured line of credit with a syndicate of U.S. banks for up to \$90,000,000, bearing interest at the LIBOR plus .325% expiring in October, 2000. At March 31, 1998 the Company had utilized \$7,000,000 of this line of credit. At March 31, 1997 there were no borrowings against the line of credit. The agreement between the Company and the syndicate of banks requires the Company to achieve certain financial ratios and operating results. The Company was in compliance with these covenants as of March 31, 1998.

The Company has an additional unsecured line of credit with various Taiwan financial institutions for up to \$19,750,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in New Taiwan Dollars, bearing interest at SIBOR plus .75% and expiring on various dates through November, 1998. At March 31, 1998 the Company had utilized \$16,000,000 of this line of credit.

8. EMPLOYEE BENEFIT PLANS

The Company maintains a contributory profit-sharing plan for a majority of its domestic employees meeting certain service requirements. The plan qualifies under Section 401(k) of the Internal Revenue Code, and allows employees to contribute up to 15% of their compensation, subject to maximum annual limitations prescribed by the Internal Revenue Service. Company contributions to the plan were at the discretion of the Board of Directors until January 1, 1997, when the employer match was revised to provide for a fixed and discretionary component. The Company shall make a matching contribution of up to 25% of the first 4% of the participant's eligible compensation and may award up to an additional 25% under the discretionary match. All matches are provided on a quarterly basis and require the participant to be an active employee at the end of each quarter. For the fiscal years ended March 31, 1998, 1997 and 1996, the Company contributions to the plan totaled \$525,000, \$452,000 and \$407,000, respectively.

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The Company's Employee Stock Purchase Plan (the "Purchase Plan") allows eligible employees of the Company to purchase shares of Common Stock at semi-annual intervals through periodic payroll deductions. The purchase price per share, in general, will be 85% of the lower of the fair market value of the Common Stock on the participant's entry date into the offering period or 85% of the fair market value on the semi-annual purchase date. As of March 31, 1998, 312,772 shares were available for issuance under the Purchase Plan. Since the inception of the Purchase Plan, 3,306,000 shares of Common Stock have been reserved for issuance under the Purchase Plan. During fiscal 1995, a purchase plan was adopted for employees in non-U.S. locations. The plan allows for the purchase price per share to be 100% of the lower of the fair market value of the Common Stock on the beginning or end of the semi-annual purchase plan period.

Effective January 1, 1997, the Company adopted a non-qualified deferred compensation arrangement. This plan is unfunded and is maintained primarily for the purpose of providing deferred compensation for a select group of management as defined in ERISA Sections 201, 301 and 401. There are no Company matching contributions with respect to this plan.

Substantially all employees in foreign locations are covered by a statutory pension plan. Contributions are accrued based on an actuarially determined percentage of compensation and are funded in amounts sufficient to meet statutory requirements. Pension expense amounted to \$1,202,000, \$1,316,000 and \$1,197,000 for the years ended March 31, 1998, 1997 and 1996, respectively.

The Company has an incentive compensation plan which provides for awards, based on a percentage of base salary, from an incentive pool created from operating profits of the Company, at the discretion of the Board of Directors. During the years ended March 31, 1998, 1997 and 1996, \$1,851,000, \$2,064,000 and \$1,357,000, respectively, was charged against operations for this plan.

The Company also has a plan which provides a cash bonus based on the operating profits of the Company for all employees, at the discretion of the Board of Directors. During the years ended March 31, 1998, 1997 and 1996, \$1,746,000, \$1,373,000 and \$1,025,000, respectively, was charged against operations for this plan.

9. STOCK OPTION PLANS

Under the Company's stock option plans (the "Plans"), key employees, non-employee directors and consultants may be granted incentive stock options or non-statutory stock options to purchase shares of Common Stock at a price not less than 100% of the fair value of the option shares on the grant date. Options granted under the Plans vest over the period determined by the Board of Directors at the date of grant, at periods ranging from one year to four years.

At March 31, 1998 there were 4,887,709 shares available for grant under the Plans. The per share weighted-average fair value of stock options granted under the Plans for the years ended March 31, 1998, 1997 and 1996 was \$15.61, \$9.66 and \$13.22, respectively, based on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Years Ended March 31, | | |
|-------------------------|-----------------------|-------|-------|
| | 1998 | 1997 | 1996 |
| Expected life (years) | 3.64 | 3.50 | 3.50 |
| Risk-free interest rate | 5.75% | 6.25% | 6.25% |
| Volatility | 62% | 60% | 60% |
| Dividend yield | 0% | 0% | 0% |

Under the Plans, 18,897,476 shares of Common Stock had been reserved for issuance since the inception of the Plans.

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The stock option activity is as follows:

| | Shares | Options Outstanding | |
|-------------------------------|-------------|---------------------|----------------|
| | | Weighted Average | Exercise Price |
| Outstanding at March 31, 1995 | 7,110,672 | \$ | 7.76 |
| Granted | 981,833 | | 23.77 |
| Exercised | (1,367,832) | | 4.01 |
| Canceled | (177,366) | | 10.86 |
| Outstanding at March 31, 1996 | 6,547,307 | | 10.88 |
| Granted | 2,092,952 | | 17.74 |
| Exercised | (1,314,977) | | 6.16 |
| Canceled | (967,610) | | 21.28 |
| Outstanding at March 31, 1997 | 6,357,672 | \$ | 12.50 |
| Granted | 1,631,821 | | 27.80 |
| Exercised | (778,418) | | 7.72 |
| Canceled | (1,006,781) | | 25.99 |
| Outstanding at March 31, 1998 | 6,204,294 | \$ | 14.84 |

The following table summarizes information about the stock options outstanding at March 31, 1998:

<TABLE>

<CAPTION>

| Range Exercise Prices | Options Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price |
|-------------------------|---------------------|---------------------------------------------|---------------------------------|---------------------|---------------------------------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| \$ 0.0300 - \$ 2.4070 | 423,506 | 4.64 | \$ 1.80 | 423,478 | \$ 1.80 |
| \$ 3.9630 - \$ 7.1110 | 1,322,632 | 5.47 | \$ 7.09 | 1,322,632 | \$ 7.09 |
| \$ 7.5930 - \$ 13.7220 | 1,436,296 | 6.28 | \$ 13.50 | 583,262 | \$ 13.21 |
| \$ 14.5550 - \$ 16.8330 | 953,292 | 8.15 | \$ 16.71 | 59,867 | \$ 15.68 |
| \$ 17.0000 - \$ 21.5000 | 1,257,033 | 8.77 | \$ 19.02 | 182,759 | \$ 18.03 |
| \$ 22.5000 - \$ 45.6250 | 811,535 | 8.57 | \$ 27.97 | 53,829 | \$ 25.93 |
| \$ 0.0300 - \$ 45.6250 | 6,204,294 | 7.09 | \$ 14.84 | 2,625,827 | \$ 8.94 |

</TABLE>

At March 31, 1998 and 1997, the number of options exercisable was 2,625,827 and 2,208,808, respectively, and the weighted-average exercise price of those options was \$8.94 and \$6.60, respectively.

On March 2, 1998, the Board of Directors of the Company approved an

option exchange program for options priced in excess of \$25.00. Excluding executive officers, corporate officers and directors, employees who were issued stock options in this category and who were active employees on March 2, 1998, could elect to keep their options to buy Common Stock at the original grant price or elect to exchange such options for options priced at \$21.50 per share, the fair market value of the Company's Common Stock on March 9, 1998. If the employee elected to exchange the options for options priced at \$21.50 per share, the vesting commencement date was extended by 90 days from the original vesting date. There were 534,522 shares exchanged under the option exchange program.

For certain options granted, the Company recognized as compensation expense the excess of the deemed value for accounting purposes of the Common Stock issuable upon exercise of such options over the exercise price of such options. This deferred compensation expense is amortized ratably over the vesting period of each option. During the years ended March 31, 1997 and 1996, the Company recorded compensation expense of \$30,000 and \$60,000, respectively.

The Company received a tax benefit of \$5,332,000, \$5,742,000 and \$4,130,000 for the years ended March 31, 1998, 1997 and 1996, respectively, on the exercise of non-qualified stock options and the disposition of stock acquired

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with incentive stock options or through the Purchase Plan. For financial reporting purposes, the tax effect of this deduction is accounted for as a credit to additional paid-in capital rather than as a reduction of income tax expense.

The Company applies APB Opinion No. 25 in accounting for its various stock plans and, accordingly, no compensation cost has been recognized for the Plans or the Purchase Plan in the financial statements. Had the Company determined compensation cost in accordance with SFAS No. 123, the Company's net income per share would have been reduced to the pro forma amounts indicated below:

| | | Years Ended March 31, | | |
|------------------------------|-------------|-----------------------|-----------|-----------|
| | | 1998 | 1997 | 1996 |
| | | ----- | | |
| Net income | As reported | \$ 64,368 | \$ 51,132 | \$ 43,752 |
| | Pro forma | 58,063 | 48,202 | 40,691 |
| Basic net income per share | As reported | \$ 1.21 | \$ 0.99 | \$ 0.86 |
| | Pro forma | 1.09 | 0.93 | 0.80 |
| Diluted net income per share | As reported | \$ 1.14 | \$ 0.94 | \$ 0.80 |
| | Pro forma | 1.03 | 0.88 | 0.75 |

Pro forma net income reflects only options granted during the fiscal years ended March 31, 1998, 1997 and 1996. Therefore, the full impact of calculating compensation cost for stock options under SFAS No. 123 is not reflected in pro forma net income amounts presented above because compensation cost is reflected over the options' vested period and compensation cost for options granted prior to April 1, 1995 is not considered.

10. LEASE COMMITMENTS

The Company leases office space, transportation and other equipment under capital and operating leases which expire at various dates through March, 2007. The future minimum lease commitments under these leases are payable as follows (amounts in thousands):

| Year ended March 31, ----- | Capital Leases ----- | Operating Leases ----- |
|----------------------------------|----------------------------|------------------------------|
| 1999 | \$ 2,319 | \$ 1,288 |
| 2000 | 363 | 1,099 |
| 2001 | -- | 806 |
| 2002 | -- | 591 |
| 2003 | -- | 476 |
| Thereafter | -- | 1,707 |
| | ----- | |
| Total minimum lease payments | \$ 2,682 | \$ 5,967 |
| | | ===== |

Less amount representing interest
(at rates ranging from 6.7% to 8.5%) (128)

Present value of net minimum lease payments 2,554

| | |
|---------------------------|--------|
| Less current maturities | 2,206 |
| | ----- |
| Capital lease obligations | \$ 348 |
| | ===== |

Rental expense under operating leases totaled \$2,811,000, \$2,644,000 and \$1,675,000 for the years ended March 31, 1998, 1997 and 1996, respectively.

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11. INCOME TAXES

The provision for income taxes is as follows (amounts in thousands):

| | Years Ended March 31, | | |
|-----------------------------|-----------------------|-----------|-----------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| Current expense: | | | |
| Federal | \$ 22,575 | \$ 13,814 | \$ 15,923 |
| State | 2,508 | 3,454 | 4,122 |
| Foreign | 8,139 | 4,093 | 3,539 |
| | ----- | ----- | ----- |
| | 33,222 | 21,361 | 23,584 |
| | ----- | ----- | ----- |
| Deferred expense (benefit): | | | |
| Federal | (6,315) | (1,322) | (5,922) |
| State | (702) | (331) | (1,480) |
| Foreign | (2,406) | (1,347) | -- |
| | ----- | ----- | ----- |
| | (9,423) | (3,000) | (7,402) |
| | ----- | ----- | ----- |
| | \$ 23,799 | \$ 18,361 | \$ 16,182 |
| | ===== | ===== | ===== |

The tax benefit associated with the exercise of employee stock options reduced taxes currently payable by \$5,332,000, \$5,742,000 and \$4,130,000 for the years ended March 31, 1998, 1997 and 1996, respectively.

The provision for income taxes differs from the amount computed by applying the statutory federal tax rate to income before income taxes. The sources and tax effects of the differences are as follows (amounts in thousands):

| | Years Ended March 31, | | |
|-----------------------------------------------------|-----------------------|-----------|-----------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| Computed expected provision | \$ 30,858 | \$ 24,323 | \$ 20,977 |
| State income taxes, net of federal benefit | 1,630 | 2,245 | 1,669 |
| Foreign sales corporation benefit | (3,707) | (2,552) | (2,123) |
| Foreign income taxed at lower than the federal rate | (4,982) | (5,655) | (4,341) |
| | ----- | ----- | ----- |
| | \$ 23,799 | \$ 18,361 | \$ 16,182 |
| | ===== | ===== | ===== |

Pretax income from foreign operations was \$39,554,000, \$32,172,000 and \$29,434,000 for the years ended March 31, 1998, 1997 and 1996, respectively. Unremitted foreign earnings that are considered to be permanently invested outside the United States and on which no deferred taxes have been provided, amounted to approximately \$147,874,000 at March 31, 1998.

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows (amounts in thousands):

| |
|--------------------------------|
| March 31, |
| 1998 1997 |
| ----- |

Deferred tax assets:

| | | |
|----------------------------------------------|-----------|-----------|
| Intercompany profit in inventory | \$ 15,168 | \$ 10,408 |
| Deferred income on shipments to distributors | 9,398 | 6,475 |
| Inventory reserves | 3,550 | 2,392 |
| Technology assets | 2,798 | 2,934 |
| Accrued expenses and other | 7,662 | 4,976 |
| | ----- | ----- |
| Gross deferred tax assets | 38,576 | 27,185 |
| | ----- | ----- |

Deferred tax liabilities:

| | | |
|-------------------------------------------------------------------------------|-----------|-----------|
| Property, plant and equipment, principally due to differences in depreciation | (11,071) | (8,479) |
| Other deferred liabilities | -- | (624) |
| | ----- | ----- |
| Gross deferred tax liability | (11,071) | (9,103) |
| | ----- | ----- |
| Net deferred tax asset | \$ 27,505 | \$ 18,082 |
| | ===== | ===== |

Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

The Company has benefited from a partial tax holiday for its Taiwan manufacturing operations over the past several years. The Company is currently benefiting from a tax holiday for its Thailand manufacturing operations. The aggregate dollar benefits derived from this tax holiday status approximated \$5,614,000, \$5,415,000 and \$5,003,000 for the years ended March 31, 1998, 1997 and 1996, respectively. The benefit the tax holiday status had on net income per share approximated \$0.10, \$0.10 and \$0.09 for the years ended March 31, 1998, 1997 and 1996, respectively. The Company's tax holiday status in Taiwan expired in March, 1997, and expires in Thailand in March, 2005.

12. ACCRUED LIABILITIES

Accrued liabilities consists of the following (amounts in thousands):

| | | |
|----------------------------|-----------|----------|
| | March 31, | |
| | 1998 | 1997 |
| | ----- | ----- |
| Accrued salaries and wages | \$ 7,468 | \$ 6,344 |
| Income taxes | 22,396 | 14,957 |
| Other accrued expenses | 23,588 | 15,091 |
| | ----- | ----- |
| | \$53,452 | \$36,392 |
| | ===== | ===== |

13. STOCKHOLDERS' EQUITY

Stockholder Rights Plan. On February 13, 1995, the Company's Board of Directors adopted a Stockholder Rights Plan (the "Plan"). Under the Plan, each share of the Company's Common Stock has one right which entitles the stockholder to buy 1/100th of a share of the Company's Series A Participating Preferred Stock. The rights have an exercise price of \$66.67 and expire in February, 2005. The rights become exercisable and transferable upon the occurrence of certain events.

Stock Repurchase Activity. In connection with a stock repurchase program, during the years ended March 31, 1998 and 1997, the Company purchased a total of 1,277,500 and 1,326,477 shares of the Company's Common Stock in open market activities at a total cost of \$31,481,000 and \$19,463,000 respectively. Subsequent to March 31, 1998 the Company purchased 222,500 additional shares of Common Stock at a cost of \$6,667,000. Also, in connection

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with a stock repurchase program, during fiscal 1998 and fiscal 1997 the Company sold put options for 700,000 shares and 500,000 shares of Common Stock, respectively. Pricing per share ranged from \$29.50 to \$38.81 in fiscal 1998 and from \$15.00 to \$24.88 in fiscal 1997. Subsequent to March 31, 1998 the Company sold put options for 100,000 shares of Common Stock. Pricing per share was \$27.50. During fiscal 1998 and 1997, the Company repurchased put options for 300,000 and 142,500 shares, respectively. As of March 31, 1998, the Company had outstanding put options for 400,000 shares which have expiration dates ranging from June 16, 1998 to March 3, 1999 at prices ranging from \$29.63 to \$38.81 per share. The net proceeds from the sale and

repurchase of these options, in the amount of \$2,215,330 and \$427,750 for fiscal years 1998 and 1997, respectively, has been credited to additional paid-in capital.

Subsequent to March 31, 1998, the Company completed two transactions in connection with the stock repurchase program. April, 1998 the Company completed a costless collar transaction for 500,000 calls priced at \$25.95 and 665,000 puts priced at \$25.19. The expiration date of the transaction is April 23, 1999. Also in connection with the stock repurchase program, the Company completed a net share settled forward contract for 2,000,000 shares at an average price of \$29.24. The expiration date of this transaction is May, 2000 with quarterly interim settlement dates as determined by the Company.

Also subsequent to March 31, 1998 the Company's Board of Directors authorized an additional share repurchase of Common Stock of 2,000,000 shares and to sell up to 500,000 additional put options. The Company expects from time to time to purchase shares of Common Stock in connection with its authorized Common Stock repurchase plan.

14. GEOGRAPHIC INFORMATION

The Company operates in one industry segment and engages primarily in the design, development, manufacture and marketing of semiconductor products. The Company sells its products to system manufacturers and distributors in a broad range of industries, performs on-going credit evaluations of its customers and generally requires no collateral. The Company's operations outside the United States consist of comprehensive product final test facilities in Taiwan and Thailand and sales offices in certain foreign countries. Domestic operations are responsible for the design, development and wafer fabrication of all products, as well as the coordination of production planning and shipping to meet worldwide customer commitments. The Taiwan and Thailand test facilities are reimbursed in relation to value added with respect to test operations and other functions performed, and certain foreign sales offices receive a commission on export sales within their territory. Accordingly, for financial statement purposes, it is not meaningful to segregate sales or operating profits for the test and foreign sales office operations. Identifiable assets by geographic area are as follows (amounts in thousands):

| | March 31, | |
|---------------|-----------|-----------|
| | 1998 | 1997 |
| | ----- | |
| United States | \$306,142 | \$254,477 |
| Taiwan | 136,128 | 101,036 |
| Thailand | 57,374 | 44,126 |
| Other | 25,099 | 28,453 |
| | ----- | ----- |
| Total Assets | \$524,743 | \$428,092 |
| | ===== | ===== |

Sales to unaffiliated customers located outside the United States, primarily in Asia and Europe, aggregated approximately 68%, 66% and 65% of consolidated net sales for the years ended March 31, 1998, 1997 and 1996, respectively.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of cash equivalents approximates fair value because their maturity is less than three months. The carrying amount of accounts receivable, accounts payable and accrued liabilities approximates fair value due to the short term maturity of the amounts. The fair value of capital lease obligations, long-term debt and lines of credit approximate their carrying value as they are estimated by discounting the future cash flows at rates currently offered to the Company for similar debt instruments.

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The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to reduce its exposure to fluctuations in foreign exchange rates. These financial instruments include standby letters of credit and foreign currency forward contracts. When engaging in forward contracts, risks arise from the possible inability of counterparties to meet the terms of their contracts and from movements in securities values, interest rates and foreign exchange rates. At March 31, 1998 and 1997, the Company held contracts totaling \$9,158,000 and \$5,421,000, respectively, which were entered into and hedged the Company's foreign currency risk. The contracts matured in April and May of 1998 and 1997, respectively. Unrealized gains and losses as of the balance sheet dates and realized

gains and losses for the years ending March 31, 1998, 1997 and 1996 were not material.

16. 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):

| | Years Ended March 31, | | |
|------------------------------------------------------------------|-----------------------|----------|----------|
| | 1998 | 1997 | 1996 |
| Net income | \$64,368 | \$51,132 | \$43,752 |
| Weighted average common shares outstanding | 53,376 | 51,569 | 50,750 |
| Dilutive effect of stock options | 2,937 | 3,114 | 3,783 |
| Weighted average common and common equivalent shares outstanding | 56,313 | 54,683 | 54,533 |
| Basic net income per share | \$ 1.21 | \$ 0.99 | \$ 0.86 |
| Diluted net income per share | \$ 1.14 | \$ 0.94 | \$ 0.80 |

17. QUARTERLY RESULTS (UNAUDITED)

The following table presents the Company's selected unaudited quarterly operating results for eight quarters ended March 31, 1998. The Company believes that all necessary adjustments have been made to present fairly the related quarterly results (in thousands except per share amounts).

<TABLE>
<CAPTION>

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Total |
|------------------------------|---------------|----------------|---------------|----------------|-----------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Fiscal 1998 | | | | | |
| Net sales | \$ 97,228 | \$103,036 | \$103,550 | \$ 93,080 | \$396,894 |
| Gross profit | 49,393 | 52,141 | 49,804 | 46,018 | 197,356 |
| Operating income | 23,955 | 25,563 | 17,583 | 19,344 | 86,445 |
| Net income | 17,832 | 19,182 | 13,127 | 14,227 | 64,368 |
| Diluted net income per share | .32 | .34 | .23 | .26 | 1.14 |
| Fiscal 1997 | | | | | |
| Net sales | \$ 74,161 | \$ 79,510 | \$ 87,076 | \$ 93,505 | \$334,252 |
| Gross profit | 36,636 | 39,788 | 43,514 | 46,984 | 166,922 |
| Operating income | 9,545 | 18,517 | 20,791 | 22,204 | 71,057 |
| Net income | 6,686 | 13,126 | 14,755 | 16,565 | 51,132 |
| Diluted net income per share | 0.12 | 0.24 | 0.27 | 0.30 | 0.94 |

</TABLE>

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18. SUPPLEMENTAL FINANCIAL INFORMATION

Cash paid for income taxes amounted to \$19,857,000, \$8,108,000 and \$17,557,000 during the years ended March 31, 1998, 1997 and 1996, respectively. Cash paid for interest amounted to \$796,000, \$3,183,000 and \$2,643,000 during the years ended March 31, 1998, 1997 and 1996, respectively.

A summary of additions and deductions related to the allowances for accounts receivable and inventories for the years ended March 31, 1998, 1997 and 1996 follows:

| Balance at beginning of year | Charged to costs and expenses | Deductions | Balance at end of year |
|------------------------------|-------------------------------|------------|------------------------|
| ----- | ----- | ----- | ----- |

Allowance for doubtful accounts:

| | | | | |
|------|----------|--------|----------|----------|
| 1998 | \$ 2,094 | \$ 638 | \$ (340) | \$ 2,392 |
| 1997 | 1,834 | 452 | (192) | 2,094 |

1996 1,394 634 (194) 1,834

Allowance for inventory valuation:

1998 \$ 8,331 \$ 2,126 \$ (934) \$ 9,523
 1997 10,372 1,886 (3,927) 8,331
 1996 4,373 7,639 (1,640) 10,372

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 EXHIBIT INDEX

<TABLE>
 <CAPTION>

| Exhibit No. | Description | Page No. |
|-------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| ----- | ----- | ----- |
| <S> | <C> | <C> |
| 3.1 | Restated Certificate of Incorporation of Registrant [Incorporated by reference to Exhibit 3.1 to Registration Statement No. 33-70608] | |
| 3.1.1 | Certificate of Amendment to Registrant's Restated Certificate of Incorporation [Incorporated by reference to Exhibit 3.3.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1994] | |
| 3.1.2 | Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of Registrant [Incorporated by reference to Exhibit No. 3.1.2 to Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1995] | |
| 3.1.3 | Certificate of Amendment to Registrant's Restated Certificate of Incorporation [Incorporated by reference to Exhibit No. 1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995] | |
| 3.1.4 | Certificate of Amendment to Registrant's Certificate of Incorporation [Incorporated by reference to Exhibit No. 3.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997] | |
| 3.2 | Amended and Restated By-Laws of Registrant, as amended through May 19, 1997 [Incorporated by reference to Exhibit No. 3.2 to Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1997] | |
| 4.1 | Preferred Share Rights Agreement dated as of February 13, 1995 between Registrant and Bank One, Arizona, N.A., including the form of Rights Certificate and the Summary of Rights attached as exhibits thereto [Incorporated by reference to Exhibit No. 1 to Registrant's Registration Statement on Form 8-A as filed with the Securities and Exchange Commission as of February 14, 1995] | |
| 10.1 | Form of Indemnification Agreement between Registrant and its directors and certain of its officers [Incorporated by reference to Exhibit No. 10.1 to Registration Statement No. 33-57960] | |
| 10.2 | Land Lease Contract dated January 1, 1989 between Registrant's subsidiary and Kaohsiung Export Processing Zone Administration Summary (English Summary) [Incorporated by reference to Exhibit No. 10.10 to Registration Statement No. 33-57960] | |
| 10.3 | Land Lease Contract dated September 1, 1992 between Registrant's subsidiary and Kaohsiung Export Processing Zone Administration Summary (English Summary) [Incorporated by reference to Exhibit No. 10.11 to Registration Statement No. 33-57960] | |
| 10.4 | Amended and Restated 1989 Stock Option Plan [Incorporated by reference to Exhibit No. 10.14 to Registration Statement No. 33-57960] | |

</TABLE>

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 EXHIBIT INDEX

<TABLE>
 <CAPTION>

| Exhibit No. | Description | Page No. |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| ----- | ----- | ----- |
| <S> | <C> | <C> |
| 10.5 | 1993 Stock Option Plan, as amended through April 25, 1997 [Incorporated by reference to Exhibit 10.11 to Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1997] | |
| 10.6 | Form of Notice of Grant For 1993 Stock Option Plan, with Exhibit A thereto, Form of Stock Option Agreement; and Exhibit B | |

thereto, Form of Stock Purchase Agreement [Incorporated by reference to Exhibit No. 10.6 Registration Statement No. 333-872]

- 10.7 Employee Stock Purchase Plan, as amended through April 25, 1997 [Incorporated by reference to Exhibit 10.13 to Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1997]
- 10.8 Form of Stock Purchase Agreement for Employee Stock Purchase Plan [Incorporated by reference to Exhibit No. 10.2 to Registration Statement No. 333-872]
- 10.9 Form of Enrollment Form For Employee Stock Purchase Plan [Incorporated by reference to Exhibit No. 10.3 to Registration Statement No. 333-872]
- 10.10 Form of Change Form For Employee Stock Purchase Plan [Incorporated by reference to Exhibit No. 10.4 to Registration Statement No. 333-872]
- 10.11 Form of Executive Officer Severance Agreement [Incorporated by reference to Exhibit No. 10.7 to Registration Statement No. 333-872]
- 10.12 Credit Agreement dated as of October 28, 1997 among Registrant, the Banks named therein, Bank One, Arizona, NA as Administrative Agent and The First National Bank of Chicago, as Documentation Agent [Incorporated by reference to Exhibit No. 10.1 to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1997]
- 10.13 Modification Agreement dated as of March 30, 1998 to the Credit Agreement dated as of October 28, 1997 among Registrant, the Banks named therein, Bank One, Arizona, NA, as Administrative Agent and The First National Bank of Chicago, as Documentation Agent
- 10.14 Development Agreement dated as of August 29, 1997 by and between Registrant and the City of Chandler, Arizona [Incorporated by reference to Exhibit No. 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997]

</TABLE>

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EXHIBIT INDEX

<TABLE>

<CAPTION>

Exhibit No. -----

Description -----

Page No. -----

<S>

<C>

<C>

- 10.15 Development Agreement dated as of July 17, 1997 by and between Registrant and the City of Tempe, Arizona [Incorporated by reference to Exhibit No. 10.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997]
- 10.16 1997 Nonstatutory Stock Option Plan
- 10.17 Form of Notice of Grant For 1997 Nonstatutory Stock Option Plan, with Exhibit A thereto, Form of Stock Option Agreement
- 10.18 International Employee Stock Purchase Plan as Amended Through April 25, 1997 [Incorporated by reference to Exhibit 10 to Registration Statement No. 333-40791]
- 18.1 Letter from KPMG Peat Marwick LLP re: Change in Accounting Principles [Incorporated by reference to Exhibit No. 18.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997]
- 21.1 Subsidiaries of Registrant [Incorporated by reference to Exhibit No. 21.1 to Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 1996]
- 23.1 Consent of KPMG Peat Marwick LLP
- 24.1 Power of Attorney Re: Microchip Technology Incorporated, the Registrant

</TABLE>

MODIFICATION AGREEMENT

BY THIS MODIFICATION AGREEMENT (the "Agreement"), made and entered into as of the 30th day of March, 1998, BANK ONE, ARIZONA, NA, a national banking association, as administrative agent for the Banks (as hereinafter defined) (the "Administrative Agent"), and MICROCHIP TECHNOLOGY INCORPORATED, a Delaware corporation (the "Borrower"), in consideration of the mutual covenants herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, hereby confirm and agree as follows:

RECITALS:

A. Borrower, the Administrative Agent, The First National Bank of Chicago, a national banking association, as Documentation Agent and the "Banks" named therein entered into that Credit Agreement dated October 28, 1997 (the "Credit Agreement") to provide financial accommodations to the Borrower as provided therein.

B. Borrower and the Administrative Agent, with the consent of the Banks, desire to modify the Credit Agreement as set forth herein.

C. All undefined capitalized terms used herein shall have the meaning given them in the Credit Agreement.

AGREEMENT:

SECTION 1. ACCURACY OF RECITALS.

Borrower acknowledges the accuracy of the Recitals.

SECTION 2. MODIFICATION OF CREDIT AGREEMENT.

2.1 Section 6.9 of the Credit Agreement is hereby amended to read as follows:

SECTION 6.9 Debt/EBITDA Ratio. At any time, permit the ratio of (i) the sum of its Consolidated Debt plus its Convertible Subordinated Indebtedness, less its accruals and accounts payables and deferred income, to (ii) its Cash Flow to be greater than 0.8 to 1.0.

2.2 Each of the Loan Documents is modified to provide that it shall be a default or an event of default thereunder if Borrower shall fail to comply with any of the covenants of Borrower herein or if any representation or warranty by Borrower herein is materially incomplete, incorrect, or misleading as of the date hereof.

2.3 Each reference in the Loan Documents to any of the Loan Documents is hereby amended to be a reference to such document as modified herein.

SECTION 3. RATIFICATION OF LOAN DOCUMENTS.

The Loan Documents are ratified and affirmed by Borrower and shall remain in full force and effect as modified herein.

SECTION 4. BORROWER REPRESENTATIONS AND WARRANTIES.

Borrower represents and warrants to the Banks:

4.1 No default or event of default under any of the Loan Documents as modified herein, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Loan Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change taken as a whole, in the financial condition of Borrower or any other person whose financial statement has been delivered to the Administrative Agent in connection with the Loans from the most recent financial statement received by the Administrative Agent.

4.3 Each and all representations and warranties of Borrower in the Loan Documents are accurate in all material respects on the date hereof.

4.4. Borrower has no claims, counterclaims, defenses, or set-offs with respect to the Loans or the Loan Documents as modified herein.

4.5 The Loan Documents as modified herein are the legal, valid, and binding obligation of Borrower, enforceable against Borrower in accordance with their terms.

SECTION 5. BORROWER COVENANTS.

Borrower covenants with the Banks:

5.1 Borrower shall execute, deliver, and provide to the Administrative Agent such additional agreements, documents, and instruments as reasonably required by the Banks to effectuate the intent of this Agreement.

5.2 Borrower fully, finally, and absolutely and forever releases and discharges the Banks and the Administrative Agent and their present and former directors, shareholders, officers, employees, agents, representatives, successors and assigns, and their separate and respective heirs, personal representatives, successors and assigns, from any and all actions, causes of action, claims, debts, damages, demands, liabilities, obligations, and suits, of whatever kind or nature,

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in law or equity of Borrower, whether now known or unknown to Borrower, and whether contingent or matured, (i) in respect of the Loans, the Loan Documents, or the actions or omissions of the Banks and the Administrative Agent in respect of the Loans or the Loan Documents and (ii) arising from events occurring prior to the date of this Agreement.

SECTION 6. CONDITIONS PRECEDENT.

The agreements of the Banks and the Administrative Agent and the modifications contained herein shall not be binding upon the Banks until the Banks have executed and delivered consents to this Agreement and the Administrative Agent has received, at Borrower's expense, all of the following, all of which shall be in form and content satisfactory to the Administrative Agent and shall be subject to approval by Administrative Agent:

6.1 An original of this Agreement fully executed by the Borrower.

6.2 Such resolutions or authorizations and such other documents as the Administrative Agent may require relating to the existence and good standing of the Borrower, and the authority of any person executing this Agreement or other documents on behalf of the Borrower.

6.3 Payment of all the internal and external costs and expenses incurred by the Administrative Agent in connection with this Agreement (including, without limitation, inside and outside attorneys, expenses, and fees).

SECTION 7. INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR

WAIVER.

The Loan Documents as modified herein contain the complete understanding and agreement of Borrower and the Banks in respect of the Loans and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision of the Loan Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the parties thereto.

SECTION 8. BINDING EFFECT.

The Loan Documents as modified herein shall be binding upon and shall inure to the benefit of Borrower and the Banks and their successors and assigns and the executors, legal administrators, personal representatives, heirs, devisees, and beneficiaries of Borrower, provided, however, Borrower may not assign any of its right or delegate any of its obligation under the Loan Documents and any purported assignment or delegation shall be void.

SECTION 9. CHOICE OF LAW.

This Agreement shall be governed by and construed in accordance with the laws of the State of Arizona, without giving effect to conflicts of law principles.

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SECTION 10. COUNTERPART EXECUTION.

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same document. Signature pages may be detached from the counterparts and attached to a single copy of this Agreement to physically form one document.

DATED as of the date first above stated.

MICROCHIP TECHNOLOGY INCORPORATED,
a Delaware corporation

By: /s/ Gordon Parnell

Name: Gordon Parnell

Title: VP Controller & Treasurer

BORROWER

BANK ONE, ARIZONA, NA, a national
banking association

By: /s/ Steve Reinhart

Name: Steve Reinhart

Title: Vice President

ADMINISTRATIVE AGENT

-4-

CONSENT OF THE BANKS

Re: Microchip Technology Incorporated

The following:

(a) is a Bank named in that Credit Agreement dated October 28, 1997 between Microchip Technology Incorporated, a Delaware corporation (the "Borrower"), Bank One, Arizona, NA, a national banking association, as administrative agent for the Banks (the "Administrative Agent"), The First National Bank of Chicago, a national banking association, as Documentation Agent, and the Banks; and

(b) consents to that Modification Agreement dated March 30, 1998 entered into between the Borrower and the Administrative Agent.

THE FIRST NATIONAL BANK OF CHICAGO, a
national banking association

By: /s/ Mark A. Isley

Name: Mark A. Isley

Title: First Vice President

"Documentation Agent" and "Bank"
CONSENT OF THE BANKS

Re: Microchip Technology Incorporated

The following:

(a) is a Bank named in that Credit Agreement dated October 28, 1997 between Microchip Technology Incorporated, a Delaware corporation (the "Borrower"), Bank One, Arizona, NA, a national banking association, as administrative agent for the Banks (the "Administrative Agent"), The First National Bank of Chicago, a national banking association, as Documentation Agent, and the Banks; and

(b) consents to that Modification Agreement dated March 30, 1998 entered into between the Borrower and the Administrative Agent.

THE INDUSTRIAL BANK OF JAPAN, LIMITED,
San Francisco Agency

By: /s/ Haruhiko Masuda

Name: Haruhiko Masuda

Title: Deputy General Manager

"Bank"

-2-

CONSENT OF THE BANKS

Re: Microchip Technology Incorporated

The following:

(a) is a Bank named in that Credit Agreement dated October 28, 1997 between Microchip Technology Incorporated, a Delaware corporation (the "Borrower"), Bank One, Arizona, NA, a national banking association, as administrative agent for the Banks (the "Administrative Agent"), The First National Bank of Chicago, a national banking association, as Documentation Agent, and the Banks; and

(b) consents to that Modification Agreement dated March 30, 1998 entered into between the Borrower and the Administrative Agent.

NORWEST BANK ARIZONA, N.A.

By: /s/ Mae G. DelaBarre

Name: Mae G. DelaBarre

Title: Vice President

"Bank"

-3-

CONSENT OF THE BANKS

Re: Microchip Technology Incorporated

The following:

(a) is a Bank named in that Credit Agreement dated October 28, 1997 between Microchip Technology Incorporated, a Delaware corporation (the "Borrower"), Bank One, Arizona, NA, a national banking association, as administrative agent for the Banks (the "Administrative Agent"), The First National Bank of Chicago, a national banking association, as Documentation Agent, and the Banks; and

(b) consents to that Modification Agreement dated March 30, 1998 entered into between the Borrower and the Administrative Agent.

WELLS FARGO BANK, N.A.

By: /s/ Stephanie Arnold

Name: Stephanie Arnold

Title: Vice President

"Bank"

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MICROCHIP TECHNOLOGY INCORPORATED
1997 NONSTATUTORY STOCK OPTION PLAN

NOVEMBER 10, 1997

ARTICLE I

1.1. PURPOSES OF THE PLAN. The purposes of this Nonstatutory Stock Option Plan are:

- o to attract and retain the best available personnel for positions of substantial responsibility;
- o to provide additional incentive to Employees and Consultants, and
- o to promote the success of the Company's business.

Options granted under the Plan will be Nonstatutory Stock Options.

1.2. DEFINITIONS. As used herein, the following definitions shall apply:

(a) "Administrator" means the Board or the Employee Committee as shall be administering the Plan, in accordance with Section 1.4 of the Plan.

(b) "Applicable Laws" means the requirements relating to the administration of stock option plans under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Options are, or will be, granted under the Plan.

(c) "Board" means the Board of Directors of the Company.

(d) "Code" means the Internal Revenue Code of 1986, as amended.

(e) "Common Stock" means the common stock, par value \$0.001 per share, of the Company.

(f) "Company" means Microchip Technology Incorporated, a Delaware corporation.

(g) "Consultant" means any person, including an advisor but not including Directors, engaged by the Company or a Parent or Subsidiary to render services to such entity.

(h) "Director" means a member of the Board.

(i) "Disability" means total or permanent disability as defined in Code Section 22(e)(3).

(j) "Employee" means any person, excluding Officers and Directors, employed by the Company or any Parent or Subsidiary of the Company. A Service Provider shall not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, any Subsidiary, or any successor. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute "employment" by the Company.

(k) "Employee Committee" means a committee of Directors appointed by the Board in accordance with Section 1.4 of the Plan.

(l) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(m) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system for the market trading day on the date of determination or the closing sales price on the last market trading day prior to the date of determination if there is no reported closing sales price on the date of determination, as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized

securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the last market trading day prior to the day of determination, as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(n) "Notice of Grant" means a written or electronic notice evidencing certain terms and conditions of an individual Option grant. The Notice of Grant is part of the Option Agreement.

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(o) "Officer" means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder or who is otherwise considered an "officer" under applicable NASD or stock exchange rules.

(p) "Option" means a nonstatutory stock option granted pursuant to the Plan, that is not intended to qualify as an incentive stock option within the meaning of Code Section 422 and the regulations promulgated thereunder.

(q) "Option Agreement" means an agreement between the Company and an Optionee evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.

(r) "Optioned Stock" means the Common Stock subject to an Option.

(s) "Optionee" means the holder of an outstanding Option granted under the Plan.

(t) "Parent" means "parent corporation," whether now or hereafter existing, as defined in Code Section 424(e).

(u) "Plan" means this 1997 Nonstatutory Stock Option Plan.

(v) "Service Provider" means an Employee or Consultant.

(w) "Share" means a share of the Common Stock, as adjusted in accordance with Section 1.3(b), 2.2 and 2.3 of the Plan.

(x) "Subsidiary" means a "subsidiary corporation," whether now or hereafter existing, as defined in Code Section 424(f).

1.3. STOCK SUBJECT TO THE PLAN.

(a) Reservation of Shares; Unpurchased Shares. Subject to the provisions of Sections 1.3(b), 2.2 and 2.3 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is 2,000,000 Shares. The Shares may be authorized, but unissued, or reacquired Common Stock including shares repurchased by the Company on the open market.

If an Option expires or becomes unexercisable without having been exercised in full, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated).

If Shares otherwise issuable under the Plan are withheld by the Company in satisfaction of the withholding taxes incurred in connection with the exercise of an outstanding Option, then the number of Shares available for issuance shall be reduced by the gross number of Shares for which the Option is exercised, and not by the net number of Shares actually issued to the Optionee.

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(b) 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 Company's receipt of consideration, then appropriate adjustments shall be made to (i) the maximum number and/or class of securities issuable under the Plan, and (ii) the number and/or class of securities and price per share in effect under each Option outstanding under the 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.

1.4. ADMINISTRATION OF THE PLAN.

(a) Administration of the Plan. The Plan shall be administered by 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 Plan. Unless otherwise required by law, decisions among members of an Administrator shall be by majority vote.

(b) Term on Committee. Members of 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 the Employee Committee.

(c) Powers of the Administrator. Subject to the provisions of the Plan, the Administrator shall have the authority, in its discretion:

- (i) to determine the Fair Market Value of the Common Stock;
- (ii) to select the Service Providers to whom Options may be granted hereunder;
- (iii) to determine whether and to what extent Options are granted hereunder;
- (iv) to determine the number of shares of Common Stock to be covered by each Option granted hereunder;
- (v) to approve forms of agreement for use under the Plan;
- (vi) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Options may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction
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or limitation regarding any Option or the shares of Common Stock relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine;
- (vii) to reduce the exercise price of any Option to the then current Fair Market Value if the Fair Market Value of the Common Stock covered by such Option shall have declined since the date the Option was granted;
- (viii) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan;
- (ix) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;
- (x) to modify or amend each Option (subject to Section 3.1(b) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Options longer than is otherwise provided for in the Plan as provided in Section 2.1(g);
- (xi) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Option or previously granted by the Administrator;
- (xii) to determine the terms and restrictions applicable to Options;
- (xiii) to allow Optionees to satisfy withholding tax obligations as provided in Section 3.2; and
- (xiv) to make all other determinations deemed necessary or advisable for administering the Plan.

(d) Effect of Administrator's Decision. The Administrator's decisions, determinations and interpretations shall be final and binding on all Optionees and any other holders of Options.

(e) Indemnification. In addition to such other rights of indemnification as they may have, the members of each 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 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.

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1.5. ELIGIBLE PERSONS UNDER THE PLAN. The persons eligible to participate in the Plan are Employees and Consultants.

ARTICLE II OPTION GRANTS

2.1. TERMS AND CONDITIONS OF OPTIONS.

(a) General. Options granted to eligible persons pursuant to the Plan shall be authorized by action of the Administrator. Each granted Option shall be evidenced by one or more instruments in the form approved by the Administrator; provided, however, that each such instrument shall comply with the terms and conditions specified below.

(b) Option Price. The Option price per Share shall be fixed by the Administrator and 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 drawn to the Company's order;
- (ii) 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 Company, 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 Company in connection with such purchase and (B) shall provide written directives to the Company to deliver the certificates for the purchased Shares directly to such brokerage firm in order to complete the sale 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 Company. 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) Term and Exercise of Options. Each Option granted under the Plan shall be exercisable at any time or times and during such period as is determined by the Administrator and

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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.

(e) 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 Disability but not including death) while holding one or more outstanding Options under the Plan, then none of those Options shall (except to the extent otherwise provided pursuant to Section 2.1(f) below) remain exercisable for more than a ninety (90) day period (or such shorter or longer period determined by the 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 the Plan and exercisable in whole or in part on the date of said Optionee's 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 six months following the date of Optionee's death or 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 on 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 Optionee's 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 Company or any Parent or Subsidiary, then in any such event all outstanding Options held by the Optionee under the Plan shall terminate immediately and cease to be outstanding.

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(f) Discretion to Accelerate Vesting. The 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 Plan to be exercised, during the limited post-Service exercise period applicable under Section 2.1(e) above, 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.

(g) Discretion to Extend Exercise Period. The 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(e) above to such greater period of time as the Administrator shall deem appropriate. In no event, however, shall such Option be exercisable after the specified expiration date of the Option term.

(h) Definitions. For purposes of the foregoing provisions of this Section 2.1 and for all other purposes under the Plan:

- (i) The Optionee shall (except to the extent otherwise specifically provided in the applicable Option Agreement) be deemed to remain in Service for so long as such individual renders services on a periodic basis to the Company (or any Parent or Subsidiary) in the capacity of an Employee or a Consultant.
- (ii) The Optionee shall be considered to be an Employee for so long as Optionee remains in the employ of the Company 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.

(i) 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.

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2.2. CORPORATE TRANSACTIONS.

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

- (i) a merger or consolidation in which the Company is not the

surviving entity, except for a transaction the principal purpose of which is to change the State in which the Company is incorporated,

- (ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company in complete liquidation or dissolution of the Company, or
- (iii) any reverse merger in which the Company is the surviving entity but in which securities possessing more than fifty percent (50%) of the total combined voting power of the Company'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 the Plan 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 the Plan 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 Administrator at the time of the option grant. The determination of option comparability under clause (A) above shall be made by the Administrator, and its determination shall be final, binding and conclusive.

(c) Termination of Operations. Upon the consummation of the Corporate Transaction, all outstanding options under the Plan 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 the Plan 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

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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 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 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 the 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 Company. The grant of Options under the Plan shall in no way affect the right of the Company 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.

2.3. 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 Company or a person that directly or indirectly controls, is controlled by, or is under common control with, the Company) 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 Company's outstanding securities pursuant to a tender or exchange

offer made directly to the Company'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 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 the Plan upon the occurrence of the Change in Control. The Administrator shall

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also have full power and authority to condition any such option acceleration upon the subsequent termination of the Optionee's Service within a specified period following the Change in Control.

(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.

ARTICLE III MISCELLANEOUS

3.1. AMENDMENT AND TERMINATION OF THE PLAN.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend or terminate the Plan.

(b) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Optionee, unless mutually agreed otherwise between the Optionee and the Administrator, which agreement must be in writing and signed by the Optionee and the Company. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Options granted under the Plan prior to the date of such termination.

3.2 TAX WITHHOLDING.

(a) General. The Company's obligation to deliver Shares of Common Stock upon the exercise of Options for 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. An Administrator may, in its discretion and in accordance with the provisions of this Section 3.2(b) and such supplemental rules as the Administrator may from time to time adopt, provide any or all holders of Options under the Plan with the right to use Shares in satisfaction of all or part of the Federal, State and local income tax and employment tax liabilities incurred by such Optionees in connection with the exercise of their Options (the "Taxes"). Such right may be provided to any such Optionee in either or both of the following formats:

- (i) Stock Withholding. The Optionee may be provided with the election to have the Company withhold, from the Shares otherwise issuable upon the exercise of such Option, a portion of these 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 Administrator may, in its discretion, provide the Optionee with the election to deliver to the Company, at the time the Option is exercised,

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one or more Shares 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 (not to exceed one hundred percent (100%)) designated by the Optionee.

3.3 EFFECTIVE DATE AND TERM OF PLAN. The Plan is effective as of November 10, 1997 (the "Effective Date"). It shall continue in effect for ten (10) years, unless sooner terminated under Section 3.1 of the Plan.

3.4. USE OF PROCEEDS. Any cash proceeds received by the Company from the sale of Shares pursuant to Option grants under the Plan shall be used for general corporate purposes.

3.5. CONDITIONS UPON ISSUANCE OF SHARES.

(a) Legal Compliance. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise of an Option, the Company may require the person exercising such Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

(c) 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.

(d) Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect to the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

3.6. NO EMPLOYMENT/SERVICE RIGHTS. Neither the action of the Company in establishing the Plan, nor any action taken by the 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 Company (or any Parent or Subsidiary) for any period of specific duration, and the Company (or any Parent or Subsidiary 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.

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3.7. 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 other Option holder. The provisions of the Plan shall inure to the benefit of, and be binding upon, the Company and its successors or assigns, whether by Corporate Transaction or otherwise, and the 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.

(c) Plan Not Exclusive. This Plan is not intended to be the exclusive means by which the Company 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 10th day of November, 1997.

MICROCHIP TECHNOLOGY INCORPORATED,
a Delaware corporation

By /s/ Steve Sanghi

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

Attested by:

/s/ C. Philip Chapman

C. Philip Chapman
Secretary

/s/ Mary Simmons-Mothershed

Mary Simmons-Mothershed
Assistant Secretary

MICROCHIP TECHNOLOGY INCORPORATED
NOTICE OF GRANT OF STOCK OPTION
1997 NONSTATUTORY STOCK OPTION PLAN

Notice is hereby given of the following nonstatutory stock option grant (the "Option") to purchase shares of the Common Stock of Microchip Technology Incorporated, a Delaware corporation (the "Company"):

Optionee: _____
Grant Date: _____, 199__
Date Vesting Begins: _____, 199__
Vesting Period: _____
Option Price: _____
Number of Option Shares: _____
Expiration Date: _____, 200__
Type of Option: Nonstatutory Stock Option

Exercise/Vesting Schedule: The Option may be exercised for any or all of the Vested Option shares. If the Grant Date and the Date Vesting Begins are the same, then the monthly installments for the first year of the Vesting Period will vest only in a lump sum upon the Optionee's completion of twelve months of Service measured from the Grant Date, the balance will vest over the remainder of the vesting period on a monthly basis. However, if the Date Vesting Begins is not the same as the Grant Date, then the Option Shares will vest in equal monthly installments (12 x the number of years in the Vesting Period) over the Optionee's period of Service, beginning one month after the Date Vesting Begins. In no event will the Optionee vest in any additional shares following the Optionee's cessation of Service (as defined in the attached Plan).

Optionee understands that the Option is granted subject to and in accordance with the express terms and conditions of the Microchip Technology Incorporated 1997 Nonstatutory Stock Option Plan (the "Plan"). Optionee agrees to be bound by the terms and conditions of the Plan and the terms and conditions of the Option as set forth in the Stock Option Agreement attached hereto as Exhibit A.

Optionee hereby acknowledges receipt of a copy of the official Plan prospectus in the form attached hereto as Exhibit B.

NO EMPLOYMENT OF SERVICE CONTRACT. NOTHING IN THE OPTION AGREEMENT OR THE PLAN SHALL CONFER UPON THE OPTIONEE THE RIGHT TO CONTINUE IN THE EMPLOY OR SERVICE OF THE COMPANY FOR ANY PERIOD OF SPECIFIC DURATION OR INTERFERE WITH OR OTHERWISE RESTRICT IN ANYWAY THE RIGHTS OF THE COMPANY OR THE OPTIONEE, WHICH RIGHTS ARE HEREBY EXPRESSLY RESERVED BY EACH, TO TERMINATE OPTIONEE'S SERVICE AT ANY TIME FOR ANY REASON WHATSOEVER, WITH OR WITHOUT CAUSE.

Dated: _____, 199__ MICROCHIP TECHNOLOGY INCORPORATED
By: _____
Steve Sanghi, President and CEO
Optionee: _____
Address: _____
Exhibit A

STOCK OPTION AGREEMENT
1997 NONSTATUTORY STOCK OPTION PLAN

THIS AGREEMENT is made by and between Microchip Technology Incorporated, a Delaware corporation (the "Company"), and the Optionee listed on the Notice of Grant of Stock Option (the "Grant Notice") to which this Agreement is attached as Exhibit A.

Optionee is a key person associated with the Company, and the Company considers it desirable and its best interest that Optionee be given an inducement to acquire a proprietary interest in the Company and added incentive to advance the interest of the Company by possessing an option to purchase the Company's Common Stock, subject to the terms and conditions of the Company's 1997 Nonstatutory Stock Option Plan (the "Plan") which is attached to the Grant Notice as Exhibit B.

Now, therefore, it is agreed by and between the parties as follows:

1. Grant of Option. The Company hereby grants to Optionee, as of the Grant Date specified in the Grant Notice, the right, privilege and option to purchase shares of Common Stock as set forth in the Grant Notice (the "Optioned Shares"), subject in all respects to the terms, conditions and provisions of this Agreement and the Plan, which is attached to the Grant Notice as Exhibit B and incorporated by reference in this Agreement. The Optionee acknowledges having received and carefully reviewed a copy of the Plan.

2. Option Price. The option price (the "Option Price") as determined by the Administrator is set forth in the Grant Notice which has been determined by the Administrator in accordance with Sections 1.2(m) and 1.4(c) (i) of the Plan.

3. Vesting of Option.

(a) Vesting Schedule. The time at which the Optioned Shares vest and the optionholder may exercise this option with respect to such Optioned Shares shall be as set forth in the Grant Notice. Optioned Shares that have vested may be acquired at any time, and from time to time, in whole or in part, until the option expires as provided in Section 6 hereof.

(b) Acceleration. The Optioned Shares may vest on an accelerated basis only as provided in the Plan. In addition, the Administrator may, by resolution adopted after the Grant Date, allow the option to be exercised on an accelerated basis.

4. Exercise of Option.

(a) Right to Exercise. This Option is exercisable during its term in accordance with the Vesting Schedule set out in the Grant Notice and the applicable provisions of the Plan and this Option Agreement.

(b) Method of Exercise. This Option is exercisable by delivery of an exercise notice, in the form attached as Schedule A (the "Exercise Notice"), which shall state the election to exercise the Option, the number of Shares in respect of which the Option is being exercised (the "Exercised Shares"), and such other representations and agreements as may be required by the Company pursuant to the provisions of the Plan. The Exercise Notice shall be completed by the Optionee and delivered to Human Resources, ATTN: Stock Administration. The Exercise Notice shall be accompanied by payment of the aggregate Exercise Price as to all Exercised Shares. This Option shall be deemed to be exercised upon receipt by the Company of such fully executed Exercise Notice accompanied by such aggregate Exercise Price. No Shares shall be issued pursuant to the exercise of this Option unless such issuance and exercise complies with Applicable Laws. Assuming such compliance, for income tax purposes the Exercised Shares shall be considered transferred to the Optionee on the date the Option is exercised with respect to such Exercised Shares.

5. Method of Payment. Payment of the aggregate Exercise Price shall be by any of the following, or a combination thereof, at the election of the Optionee:

(a) cash;

(b) check drawn to the Company's order; or

(c) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan.

6. Termination of Option. This Option, to the extent not previously exercised, shall terminate upon the first to occur of the tenth anniversary of the Grant Date or as otherwise set forth in the Plan.

7. No Privilege of Stock Ownership. The holder of the Option granted hereunder shall not have any of the rights of a stockholder with respect to the Optioned Shares until such Optionee shall have exercised the option, paid the Option Price, and received a stock certificate for the purchased shares of Common Stock.

8. Compliance with Applicable Laws. The exercise of this Option and the issuance of the Shares upon such exercise shall be subject to compliance by the Company and the Optionee with all Applicable Laws. In connection with the exercise of this Option, Optionee shall execute and deliver to the Company such representations in writing as may be requested by the Company in order for it to comply with applicable requirements of federal and state securities laws.

9. Liability of the Company. The inability of the Company to obtain approval from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares pursuant to this Agreement shall relieve the Company of any liability with respect to the nonissuance or sale of the Shares as to which such approval shall not have been obtained. The Company, however, shall use its best efforts to obtain all such approvals.

10. NO GUARANTEE OF CONTINUED SERVICE. OPTIONEE ACKNOWLEDGES AND AGREES THAT THE VESTING OF SHARES PURSUANT TO THE VESTING SCHEDULE HEREOF IS EARNED ONLY BY CONTINUING AS A SERVICE PROVIDER AT THE WILL OF THE COMPANY (AND NOT THROUGH THE ACT OF BEING HIRED, BEING GRANTED AN OPTION OR PURCHASING SHARES HEREUNDER). OPTIONEE FURTHER ACKNOWLEDGES AND AGREES THAT THIS AGREEMENT, THE TRANSACTIONS CONTEMPLATED HEREUNDER AND THE VESTING SCHEDULE SET FORTH HEREIN DO NOT CONSTITUTE AN EXPRESS OR IMPLIED PROMISE OF CONTINUED ENGAGEMENT AS A SERVICE PROVIDER FOR THE VESTING PERIOD, FOR ANY PERIOD, OR AT ALL, AND SHALL NOT INTERFERE WITH OPTIONEE'S RIGHT OR THE COMPANY'S RIGHT TO TERMINATE OPTIONEE'S RELATIONSHIP AS A SERVICE PROVIDER AT ANY TIME, WITH OR WITHOUT CAUSE.

11. Assignability. Neither this Option nor any rights or privileges conferred thereby shall be assignable or transferable by the Optionee other than by will or by the laws of descent and distribution, and this Option shall be exercisable only by Optionee during the Optionee's lifetime. Upon the death of Optionee, the rights of the successors to Optionee shall be limited as set forth in the Plan.

12. Binding Affect. This Option Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective heirs, executors, administrators, successors and assigns.

13. Securities Matters.

(a) Exercise of Option. The option granted hereunder may be exercised by the Optionee only if (i) the Shares which are to be issued upon such execution are registered under the Securities Act of 1933, as amended (the "1933 Act"), the Arizona Securities Act, as amended (the "Arizona Act"), and the securities laws of any other applicable jurisdiction, or (ii) the Company, upon advice of counsel, determines that the issuance of the Shares upon the exercise of the Optionee is exempt from registration requirements.

(b) Restriction of Shares. The Company is under no obligation to register, under the 1933 Act, the Arizona Act or the securities laws of any other jurisdiction, any of the Shares to be issued to the Optionee upon the exercise of any option or to take any action which would make available any exemption from registration. If the Shares to be issued to the Optionee upon the exercise of any option have not been registered under the 1933 Act, the Arizona Act or the securities laws of any other jurisdiction, those Shares will be "restricted securities" within the meaning of Rule 144 under the 1933 Act and must be held indefinitely without any transfer, sale or other disposition unless (a) the shares are subsequently registered under the 1933 Act, the Arizona Act and the securities laws of any other applicable jurisdiction, or (b) the Optionee obtains an opinion of counsel which is satisfactory to counsel for the Company that the Shares may be sold in reliance on an exemption from registration requirements.

14. Tax Consequences; Withholding Taxes and Reporting of Disposition of Shares. Some of the federal tax consequences relating to this Option, as of the date of this Option, are set forth below. THIS SUMMARY IS NECESSARILY INCOMPLETE, AND THE TAX LAWS AND REGULATIONS ARE SUBJECT TO CHANGE. THE OPTIONEE SHOULD CONSULT A TAX ADVISER BEFORE EXERCISING THIS OPTION OR DISPOSING OF THE SHARES.

(a) Exercising the Option. The Optionee may incur regular federal income tax liability upon exercise of a nonstatutory stock option. The Optionee will be treated as having received compensation income (taxable at ordinary income tax rates) equal to the excess, if any, of the Fair Market Value of the Exercised Shares on the date of exercise over their aggregate Exercise Price.

(b) Withholding. If the Optionee is an Employee or a former Employee, the Company will be required to withhold from his or her compensation or collect from Optionee and pay to the applicable taxing authorities an amount in cash equal to a percentage of this compensation income at the time of exercise, and may refuse to honor the exercise and refuse to deliver Shares if such withholding amounts are not delivered at the time of exercise. Optionee hereby agrees to make appropriate arrangements with the Company for the satisfaction of any applicable federal, state or local income tax withholding requirements relating to the exercise of the Option or the payment of any employment taxes due as a result of the exercise of such Option.

(c) Disposition of Shares. If the Optionee holds Shares acquired upon the exercise of a nonstatutory stock option for at least one year, any gain realized on disposition of the Shares will be treated as long-term capital gain for federal income tax purposes.

(d) Reporting of Disposition of Shares. The Optionee shall, at the Company's request, promptly complete and return any and all informational requests regarding the Optionee's disposition of Shares acquired upon exercise of the Options covered by this Agreement.

15. Defined Terms. All capitalized terms herein which are not otherwise defined herein shall have the same meaning ascribed to such terms in the Plan.

16. Notices. Except as set forth in Section 4 of this Option Agreement, any notice required to be given or delivered to the Company under the terms of this Option Agreement shall be in writing and addressed to the Company in care of the Corporate Secretary at its principal corporate offices. Any notice required to be given or delivered to Optionee at the address indicated in the Grant Notice. All notices shall be deemed to have been given or delivered upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

17. Construction. This Option Agreement and the Option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the express terms and provisions of the Plan. Subject to Section 3.1(b) of the Plan, in the event of a conflict between the terms and conditions of the Plan and the terms and conditions of this Option Agreement, the terms and conditions of the Plan shall prevail. All decisions of the Administrator with respect to any question or issue arising under the Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

18. Entire Agreement; Governing Law. The Plan and the Grant Notice are incorporated herein by reference. This Option Agreement, the Plan and the Grant Notice constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and Optionee with respect to the subject matter hereof, and may not be modified adversely to the Optionee's interest except by means of a writing signed by the Company and the Optionee. The interpretation, performance, and enforcement of this Agreement shall be governed by the internal substantive laws, but not the choice of law rules, of the State of Arizona.

Initials of Optionee: _____
SCHEDULE A

FORM OF EXERCISE NOTICE UNDER THE
1997 NONSTATUTORY STOCK OPTION PLAN

MICROCHIP TECHNOLOGY INCORPORATED
2355 West Chandler Boulevard
Chandler, Arizona 85224
Attention: Human Resources, Stock Administration

Exercise of Option. Effective as of today, _____, 19__ , the undersigned ("Purchaser") hereby elects to purchase shares (the "Shares") of the Common Stock of Microchip Technology Incorporated (the "Company") under and pursuant to the 1997 Nonstatutory Stock Option Plan (the "Plan") for the grant(s) specified in the Stock Option Exercise Instruction Form accompanying this Exercise Notice. The purchase price for the Shares shall be as required by the individual Grant Notice(s) and Option Agreement(s).

Delivery of Payment. Purchaser herewith delivers to the Company the full purchase price for the Shares.

Representations of Purchaser. Purchaser acknowledges that Purchaser has received, read and understood the Plan, the Grant Notice and the Option Agreement and agrees to abide by and be bound by their terms and conditions.

Rights as Stockholder. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the Shares, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Shares so acquired shall be issued to the Optionee as soon as practicable after exercise of the option. No adjustment will be made for a dividend or other right for which the record date is prior to the date of issuance, except as provided in Sections 2.2 and 2.3 of the Plan.

Tax Consultation. Purchaser understands that Purchaser may suffer adverse tax consequences as a result of Purchaser's purchase or disposition of the Shares. Purchaser represents that Purchaser has consulted with any tax consultants Purchaser deems advisable in connection with the purchase or disposition of the Shares and that Purchaser is not relying on the Company for any tax advice.

Entire Agreement; Governing Law. The Plan, the Grant Notice and Option Agreement are incorporated herein by reference. This Agreement, the Plan, the Grant Notice and the Option Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and Purchaser with respect to the subject matter hereof, and may not be modified adversely to the Purchaser's interest except by means of a writing signed by the Company and Purchaser. This agreement is governed by the internal substantive laws, but not

the choice of law rules, of the State of Arizona.

Submitted by:

Accepted by:

PURCHASER:

MICROCHIP TECHNOLOGY INCORPORATED

Signature

By

Print Name

Title

Independent Auditors' Consent

The Board of Directors
Microchip Technology Incorporated:

We consent to incorporation by reference in the registration statements (No. 33-59686, No. 33-80072, No. 33-81690, No. 33-83196, No. 333-872 and No. 333-40791) on Form S-8 of Microchip Technology Incorporated of our report dated April 22, 1998, except as to the second and third paragraphs of note 13 which are as of May 18, 1998, relating to the consolidated balance sheets of Microchip Technology Incorporated and subsidiaries as of March 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended March 31, 1998, which report appears in the March 31, 1998 annual report on Form 10-K of Microchip Technology Incorporated.

/s/ KPMG Peat Marwick LLP

Phoenix, Arizona
May 22, 1998

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, That the undersigned officer and/or director of Microchip Technology Incorporated, a Delaware corporation (the "Company"), does hereby constitute and appoint STEVE SANGHI AND C. PHILIP CHAPMAN, and each of them, with full power to each of them to act alone, as the true and lawful attorneys and agents of the undersigned, with full power of substitution and resubstitution to each of said attorneys to execute, file or deliver any and all instruments and to do any and all acts and things which said attorneys and agents, or any of them, deem advisable to enable the Company to comply with the Securities Exchange Act of 1934, as amended, and any requirements of the Securities and Exchange Commission in respect thereto relating to annual reports on Form 10-K, including specifically, but without limitation of the general authority hereby granted, the power and authority to sign such person's name individually and on behalf of the Company as an officer and/or director (as indicated below opposite such person's signature) to the Company's annual reports on Form 10-K or any amendments or papers supplemental thereto; and each of the undersigned does hereby fully ratify and confirm all that said attorneys and agents or any of them, shall do or cause to be done by virtue hereof. This power of Attorney revokes any and all previous powers of attorney granted by any of the undersigned which such power would have entitled said attorneys and agents, or any of them, to sign such person's name, individually or on behalf of the Company, to any Form 10-K.

IN WITNESS WHEREOF, each of the undersigned has subscribed these presents this 30th day of January, 1998.

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|---------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| - - - - - | - - - - - |
| <S> /s/ Steve Sanghi - - - - - Steve Sanghi | <C> Director, President and Chairman of the Board (Principal Executive Officer) |
| /s/ C. Philip Chapman - - - - - C. Philip Chapman | Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer) |
| /s/ Albert J. Hugo-Martinez - - - - - Albert J. Hugo-Martinez | Director |
| /s/ Jon H. Beedle - - - - - Jon H. Beedle | Director |
| /s/ L.B. Day - - - - - L.B. Day | Director |
| /s/ Matthew W. Chapman - - - - - Matthew W. Chapman | Director |

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