

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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 or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

2355 W. Chandler Blvd., Chandler, AZ 85224-6199  
(602) 786-7200  
(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's  
Principal Executive Offices)

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

Yes X No  
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The number of shares outstanding of the issuer's common stock, as of July 24, 1998:

Common Stock, \$.001 Par Value: 50,832,783 shares

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share amounts)

<TABLE>  
<CAPTION>

## ASSETS

	June 30, 1998	March 31, 1998
	-----	-----
	(Unaudited)	
	<C>	<C>
Cash and cash equivalents	\$ 23,908	\$ 32,188
Accounts receivable, net	57,993	56,320
Inventories	69,310	66,293
Prepaid expenses	2,643	2,208
Deferred tax asset	37,521	35,778
Other current assets	1,857	1,802
	-----	-----
Total current assets	193,232	194,589
Property, plant and equipment, net	322,097	325,892
Other assets	4,212	4,262
	-----	-----
Total assets	\$ 519,541	\$ 524,743
	=====	=====

## LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term lines of credit	\$ 13,000	\$ 16,000
Accounts payable	29,035	36,049
Current maturities of long-term debt	1,880	2,196
Current maturities of capital lease obligations	1,692	2,206
Accrued liabilities	62,533	53,452
Deferred income on shipments to distributors	29,444	29,515
	-----	-----
Total current liabilities	137,584	139,418
Long-term lines of credit	45,000	7,000
Long-term debt, less current maturities	1,047	1,420
Capital lease obligations, less current maturities	186	348
Long-term pension accrual	954	976
Deferred tax liability	8,779	8,273
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 53,881,342 and outstanding 50,797,941 shares at June 30, 1998;	54	54
issued 53,881,342 and outstanding 52,870,389 shares at March 31, 1998;		
Additional paid-in capital	176,983	176,865
Retained earnings	226,967	214,193
Less shares of common stock held in treasury at cost; 3,083,401 shares at June 30, 1998 and 1,010,953 at March 31, 1998	(78,013)	(23,804)
	-----	-----
Net stockholders' equity	325,991	367,308
Total liabilities and stockholders' equity	\$ 519,541	\$ 524,743
	=====	=====

&lt;/TABLE&gt;

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)

	Three Months Ended June 30,	
	-----	-----
	1998	1997
	-----	-----
	(Unaudited)	
Net sales	\$ 99,489	\$ 97,228
Cost of sales	50,231	47,835
	-----	-----
Gross profit	49,258	49,393
Operating expenses:		
Research and development	10,216	9,210

Selling, general and administrative	16,054	16,228
Special charge	5,500	--
	-----	-----
	31,770	25,438
Operating income	17,488	23,955
Other income (expense):		
Interest income	205	740
Interest expense	(524)	(281)
Other, net	330	13
	-----	-----
Income before income taxes	17,499	24,427
Income taxes	4,725	6,595
	-----	-----
Net income	\$ 12,774	\$ 17,832
	=====	=====
Basic net income per share	\$ 0.24	\$ 0.33
	=====	=====
Diluted net income per share	\$ 0.23	\$ 0.32
	=====	=====
Weighted average common shares outstanding	52,151	53,291
	=====	=====
Weighted average common and common equivalent shares outstanding	54,486	56,432
	=====	=====

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

<TABLE>

<CAPTION>

	Three Months Ended June 30,	
	1998	1997
	----	----
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$ 12,774	\$ 17,832
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	51	144
Provision for inventory valuation	797	(400)
Provision for pension accrual	240	296
Depreciation and amortization	15,758	12,095
Amortization of purchased technology	75	75
Deferred income taxes	(1,237)	11
Increase in accounts receivable	(1,724)	(1,629)
Increase in inventories	(3,814)	(2,117)
Increase in accounts payable and accrued liabilities	2,067	20,334
Change in other assets and liabilities	(848)	6,953
	-----	-----
Net cash provided by operating activities	24,139	53,594
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(11,963)	(30,367)
	-----	-----
Net cash used in investing activities	(11,963)	(30,367)
	-----	-----
Cash flows from financing activities:		
Net proceeds from lines of credit	35,000	--
Payments on long-term debt	(689)	(725)
Payments on capital lease obligations	(676)	(741)
Repurchase of common stock	(57,890)	--

Proceeds from sale of stock and put options	3,799	2,885
	-----	-----
Net cash (used) provided by financing activities	(20,456)	1,419
	-----	-----
Net increase (decrease) in cash and cash equivalents	(8,280)	24,646
Cash and cash equivalents at beginning of period	32,188	42,999
	-----	-----
Cash and cash equivalents at end of period	\$ 23,908	\$ 67,645
	=====	=====

</TABLE>

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

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

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of the Company, the accompanying financial statements include all adjustments of a normal recurring nature which are necessary for a fair presentation of the results for the interim periods presented. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. It is suggested that these financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 1998. The results of operations for the three months ended June 30, 1998 are not necessarily indicative of the results to be expected for the full fiscal year.

(2) Special Charge

During the quarter ended June 30, 1998, the Company recognized a special charge of \$5,500,000 which was comprised of three elements: a \$3,300,000 legal settlement with another company involving an intellectual property dispute; a \$1,700,000 write-off of products obsoleted by the introduction of newer products; and a \$500,000 charge associated with the restructuring of a portion of the Company's sales organization.

(3) Accounts Receivable

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

	June 30, 1998	March 31, 1998
	-----	-----
	(unaudited)	
Trade accounts receivable	\$60,581	\$57,922
Other	892	790
	-----	-----
	61,473	58,712
Less allowance for doubtful accounts	3,480	2,392
	-----	-----
	\$57,993	\$56,320
	=====	=====

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(4) Inventories

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

	June 30, 1998	March 31, 1998
	-----	-----
	(unaudited)	
Raw materials	\$ 5,612	\$ 5,795
Work in process	46,734	40,000
Finished goods	27,269	30,021
	-----	-----
	79,615	75,816
Less allowance for inventory valuation	10,305	9,523
	-----	-----
	\$69,310	\$66,293

(5) Property, Plant and Equipment

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

	June 30, 1998	March 31, 1998
	-----	
	(unaudited)	
Land	\$ 11,749	\$ 11,749
Building and building improvements	76,120	59,725
Machinery and equipment	345,214	322,624
Projects in process	53,778	82,528
	-----	-----
	486,861	476,626
Less accumulated depreciation and amortization	164,764	150,734
	-----	-----
	\$322,097	\$325,892
	=====	=====

(6) Lines of Credit

The Company has an unsecured line of credit with a syndicate of U.S. banks for up to \$90,000,000, bearing interest at LIBOR (5.66% at June 30, 1998) plus .325% expiring in October 2000. At June 30, 1998, the Company had utilized \$45,000,000 of this line of credit. At March 31, 1998, the Company had utilized \$7,000,000 of 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 June 30, 1998.

The Company has an additional unsecured line of credit with various Taiwan financial institutions for up to \$21,340,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in New Taiwan Dollars, bearing interest at SIBOR (5.84% at June 30, 1998) plus .75% and expiring on various dates through June 1999. At June 30, 1998, the Company had utilized \$13,000,000 of this line of credit. At March 31, 1998, the Company had utilized \$16,000,000 of this line of credit.

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(7) Stockholders' Equity

Stock Repurchase Activity. In connection with a stock repurchase program, during the quarter ended June 30, 1998, the Company purchased a total of 2,222,500 shares of the Company's Common Stock in open market activities at a total cost of \$57,890,000. As of June 30, 1998, the Company had reissued 416,599 of these shares through stock option exercises and the Company's employee stock purchase plan. Also, in connection with the stock repurchase program, during the three months ended June 30, 1998, the Company sold put options for 500,000 shares of Common Stock at prices ranging from \$22.30 to \$23.75 per share. During the quarter ended June 30, 1998, the Company repurchased put options for 50,000 shares. The net proceeds from the sale and repurchase of these options, in the amount of \$1,650,000 for the three months ended June 30, 1998, has been credited to additional paid-in capital. As of June 30, 1998, the Company had outstanding put options for 950,000 shares which have expiration dates ranging from October 23, 1998 to September 13, 1999 at prices ranging from \$22.30 to \$38.81 per share.

During the quarter ended June 30, 1998, the Company completed two transactions in connection with the stock repurchase program. 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 1999. Also in connection with the stock repurchase program, the Company completed a net share settled forward contract for 2,000,000 shares of Common Stock 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 during the quarter ended June 30, 1998, the Company's Board of Directors authorized the Company to repurchase up to 2,000,000 shares of Common Stock 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.

(8) 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):

Three Months June 30,	
1998	1997
-----	-----

Net income	\$12,774	\$17,832
	=====	=====
Weighted average common shares outstanding	52,151	53,291
Dilutive effect of stock options	2,335	3,141
	-----	-----
Weighted average common and common equivalent shares outstanding	54,486	56,432
	=====	=====
Basic net income per share	\$ 0.24	\$ 0.33
	=====	=====
Diluted net income per share	\$ 0.23	\$ 0.32
	=====	=====

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(9) Comprehensive Income

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Standards (SFAS) No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes requirements for disclosure of comprehensive income and is effective for both interim and annual periods beginning after December 15, 1997. Comprehensive income is defined as the change in equity from transactions involving non-owner sources. During the quarter ended June 30, 1998, comprehensive income consists of net income of \$12,774,000 and \$1,204,500 of income after-taxes resulting from put option transactions.

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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 periods indicated:

	Three Months Ended June 30,	
	1998	1997
	-----	-----
Net sales.....	100.0%	100.0%
Cost of sales.....	50.5%	49.2%
	-----	-----
Gross profit.....	49.5%	50.8%
Research and development.....	10.3%	9.5%
Selling, general and administrative.....	16.1%	16.7%
Special charge.....	5.5%	--
	-----	-----
Operating income.....	17.6%	24.6%
	=====	=====

Quarter Ending June 30, 1998

During the quarter ended June 30, 1998, the Company recognized a special charge of \$5,500,000 which was comprised of three elements: a \$3,300,000 legal settlement with another company involving an intellectual property dispute; a \$1,700,000 write-off of products obsoleted by the introduction of newer products; and a \$500,000 charge associated with the restructuring of a portion of the Company's sales organization.

Net Sales

Microchip's net sales for the quarter ended June 30, 1998 were \$99.5 million, an increase of 2.3% over sales of \$97.2 million for the corresponding quarter of the previous fiscal year, and an increase of 6.9% from the previous quarter's sales of \$93.1 million.

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 74% and 70% of net sales in the three months ended June 30, 1998 and 1997, respectively. A related component of the Company's product sales consists primarily of Serial EEPROM memories which accounted for 26% and 30% of net sales in the three months ended June 30, 1998 and 1997, 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 has been experiencing increasing turns orders as a portion of the Company's business over the last several years and remains highly dependent on turns orders. 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.

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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 and the first quarter of fiscal 1999, 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 its customers; demand for the Company's products, work stoppages at customer locations, 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%. During the quarter ended June 30, 1998, sales to Asia increased by 22% from the prior quarter indicating a partial recovery in sales for this region. 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 68.0% and 70.0% of net sales in the three months ended June 30, 1998 and 1997, 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.

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#### Implementation of New Enterprise Software System

During the current quarter, the Company is transitioning a majority of its core business and financial systems to replace existing software systems. It is anticipated that the implementation of these systems may adversely affect shipment linearity and timeliness of customer invoicing for the quarter. While the Company believes that the implementation will not materially impact the Company's results of operations for the quarter, other companies implementing similar systems have, in certain cases, experienced difficulties in their implementations. The Company believes that transitioning to new business and financial systems will be important for the Company's operating results in future periods. However, operating results, particularly net sales, could be adversely affected if the Company experiences difficulties in implementation. See also "Year 2000 and Systems Conversion," below.

#### 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 and the first quarter of fiscal 1999 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 \$49.3 million and \$49.4 million in the three months ended June 30, 1998 and 1997, respectively. Gross profit as a percent of sales was 49.5% and 50.8% in the three months ended June 30, 1998 and 1997, respectively. Gross margins remained relatively constant during

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the quarter ended June 30, 1998, positively affected by the product mix shift to microcontrollers where margins are typically higher, offset by planned one-week shutdowns taken in the Company's Taiwan and Thailand test facilities during the quarter, and continued pricing pressure on 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 be produced 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.

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 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. 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 by 10.9% in the current quarter as compared to the corresponding quarter of the previous fiscal year, and by 4.6% from the previous quarter. 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

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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 maintained its level of investment in selling, general and administrative costs at \$16.1 million in the current quarter, as compared to \$16.2 million and \$16.9 million in the corresponding quarter of the previous fiscal year and in the immediately preceding quarter, respectively. As the Company continues to invest in incremental worldwide sales and technical support resources to promote the Company's embedded control products, selling, general and administrative costs are expected to increase over time, in relation to sales.

#### Other Income (Expense)

Interest income for the three months ended June 30, 1998 decreased from the three months ended June 30, 1997 and the prior fiscal quarter, as a result of reduced invested cash balances. Interest expense in the three months ended June 30, 1998 increased over the three months ended June 30, 1997 and the prior fiscal quarter, respectively, due to incremental borrowing levels associated with a stock repurchase program. Other income represents numerous immaterial non-operating items. The Company's interest expense could increase in the balance of fiscal 1999 if the Company increases its borrowings, and interest expense could 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% and 27.0% for the three months ended June 30, 1998 and 1997, 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.

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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. Particular emphasis is being placed on software requirements to replace existing systems related to the sales order process, planning, physical distribution and accounts receivable functions which are being implemented during the quarter ending September 30, 1998. 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 issue will pose significant operating problems. However, difficulties in the implementation of new information systems, or a failure to fully identify and resolve all Year 2000 deficiencies in the Company's systems and products could have a material adverse effect on the Company's results of operations.

#### Liquidity and Capital Resources

The Company had \$23.9 million in cash and cash equivalents at June 30, 1998, a decrease of \$8.3 million from the March 31, 1998 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 June 30, 1998 were \$45.0 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 June 30, 1998. The Company also has an unsecured short term line of credit totaling \$21.3 million with certain foreign banks. Borrowings under the foreign line of credit as of June 30, 1998 were \$13.0 million. There are no covenants related to the foreign line of credit. At June 30, 1998, an aggregate of \$53.3 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 three months ended June 30, 1998, the Company generated \$24.1 million of cash from operating activities, a decrease of \$29.5 million from the three months ended June 30, 1997. The decrease in cash flow from operations was primarily due to a special charge which decreased profitability, a lower accounts payable balance as a result of lower capital purchases, and an increase in inventories.

It is anticipated that the Company's investment in working capital will continue to grow in line with sales growth. Inventory turns are expected to remain consistent over the balance of this fiscal year reflecting the current net sales projection. The accounts receivables balance will grow in the quarter ending September 30, 1998, primarily due to reduced shipment linearity in the quarter associated with the implementation of a new information system. It is anticipated that accounts receivable balances will return to historical levels in future quarters, in relationship to sales. See also "Implementation of New Enterprise Software System," above.

The foregoing statements regarding inventory turns, accounts receivable balances for the quarter ending September 30, 1998 and future quarters, and shipment linearity 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.

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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; timeliness of customer invoicing; 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 its customers; demand for the Company's products, work stoppages at customer locations, 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; and difficulties in implementing new enterprise software system.

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 three months ended June 30, 1998 and 1997 were \$12.0 million and \$30.4 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 \$20.5 million for the three months ended June 30, 1998. Net cash provided by financing activities was \$1.4 million for the three months ended June 30, 1997. Proceeds from sale of stock and put options were \$3.8 million and \$2.9 million for the three months ended June 30, 1998 and 1997, respectively. Payments on long term debt and capital lease obligations were \$1.4 million and \$1.5 million for the three months ended June 30, 1998 and 1997, respectively. Proceeds from lines of credit were \$35.0 million for the three months ended June 30, 1998. Cash expended for the purchase of the Company's Common Stock was \$57.9 million for the three months ended June 30, 1998.

On May 1, 1998, the Company's Board of Directors authorized the repurchase of 2,000,000 shares, in connection with a Common Stock repurchase plan. On May 1, 1998, the Board of Directors also authorized the Company to sell up to 500,000 put options in connection with the same plan. During the quarter ended June 30, 1998, the Company has purchased 2,222,500 shares of Common Stock at an aggregate cost of \$57,890,000 and had outstanding 950,000 put options at prices ranging from \$22.30 to \$38.81. The Company expects from time to time to purchase shares of Common Stock in connection with its authorized Common Stock repurchase plan.

During the quarter ended June 30, 1998, the Company completed two transactions in connection with a stock repurchase program. In 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 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 \$29.27. The expiration date of this transaction is May 2000, with quarterly interim settlement dates as determined by the Company. These derivative transactions could obligate the Company to purchase shares of the Company's Common Stock in the future if the stock price is below the strike price of the instruments.

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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 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

None.

(b) Reports on Form 8-K.

The registrant did not file any reports on Form 8-K during the quarter ended June 30, 1998.

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SIGNATURES

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

MICROCHIP TECHNOLOGY INCORPORATED

Date: August 4, 1998

By: /s/ C. Philip Chapman

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C. Philip Chapman  
Vice President, Chief Financial Officer  
and Secretary (Duly Authorized Officer, and  
Principal Financial and Accounting Officer)

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