

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 DECEMBER 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
(State or Other Jurisdiction of
Incorporation or Organization)

86-0629024
(I.R.S. Employer
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

The number of shares outstanding of the issuer's common stock, as of January 29, 1998:

COMMON STOCK, \$.001 PAR VALUE: 50,712,393 SHARES

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share amounts)

<TABLE>
<CAPTION>

	ASSETS	
	December 31, 1998	March 31, 1998
	-----	-----
	(Unaudited)	
<S>	<C>	<C>
Cash and cash equivalents	\$ 24,961	\$ 32,188
Accounts receivable, net	56,206	56,320
Inventories	72,109	66,293
Prepaid expenses	3,224	2,208
Deferred tax asset	41,751	35,778
Other current assets	1,797	1,802
	-----	-----
Total current assets	200,048	194,589
Property, plant and equipment, net	306,594	325,892
Other assets	4,146	4,262
	-----	-----
Total assets	\$ 510,788	\$ 524,743
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term lines of credit	\$ 13,800	\$ 16,000
Accounts payable	24,580	36,049
Current maturities of long-term debt	1,260	2,196
Current maturities of capital lease obligations	726	2,206
Accrued liabilities	48,988	53,452
Deferred income on shipments to distributors	29,720	29,515
	-----	-----
Total current liabilities	119,074	139,418
Long-term lines of credit	28,000	7,000
Long-term debt, less current maturities	521	1,420
Capital lease obligations, less current maturities	--	348
Long-term pension accrual	910	976
Deferred tax liability	9,652	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 50,651,256 shares at December 31, 1998; issued 53,881,342 and outstanding 52,870,389 shares at March 31, 1998	54	54
Additional paid-in capital	173,050	176,865
Retained earnings	262,384	214,193
Less shares of common stock held in treasury at cost; 3,230,086 shares at December 31, 1998 and 1,010,953 at March 31, 1998	(82,857)	(23,804)
	-----	-----
Net stockholders' equity	352,631	367,308
Total liabilities and stockholders' equity	\$ 510,788	\$ 524,743
	=====	=====

</TABLE>

See accompanying notes to condensed consolidated financial statements

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)

<TABLE>
<CAPTION>

Three Months Ended	Nine Months Ended
December 31,	December 31,

	1998	1997	1998	1997
	(Unaudited)		(Unaudited)	
<S>	<C>	<C>	<C>	<C>
Net sales	\$ 100,167	\$ 103,550	\$ 303,436	\$ 303,814
Cost of sales	49,525	53,746	152,063	152,476
Gross profit	50,642	49,804	151,373	151,338
Operating expenses:				
Research and development	10,140	10,009	31,098	28,599
Selling, general and administrative	15,382	17,212	47,503	50,638
Special charge	--	5,000	5,500	5,000
	25,522	32,221	84,101	84,237
Operating income	25,120	17,583	67,272	67,101
Other income (expense):				
Interest income	143	755	563	2,340
Interest expense	(845)	(267)	(2,407)	(835)
Other, net	38	(89)	586	80
Income before income taxes	24,456	17,982	66,014	68,686
Income taxes	6,602	4,855	17,823	18,545
Net income	\$ 17,854	\$ 13,127	\$ 48,191	\$ 50,141
Basic net income per share	\$ 0.35	\$ 0.24	\$ 0.94	\$ 0.94
Diluted net income per share	\$ 0.34	\$ 0.23	\$ 0.90	\$ 0.89
Weighted average common shares outstanding	50,647	53,762	51,422	53,362
Weighted average common and common equivalent shares outstanding	53,192	56,822	53,819	56,557

</TABLE>

See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended December 31,	
	1998	1997
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$ 48,191	\$ 50,141
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	216	456
Provision for inventory valuation	1,567	669
Provision for pension accrual	708	954
Special charges	--	5,000
Depreciation and amortization	48,978	39,055
Amortization of purchased technology	225	225
Deferred income taxes	(4,594)	(4,368)
Increase in accounts receivable	(102)	(1,407)
Increase in inventories	(7,383)	(2,598)
Increase (decrease) in accounts payable and accrued liabilities	(15,933)	25,749
Change in other assets and liabilities	(1,689)	11,413
Net cash provided by operating activities	70,184	125,289

Cash flows from investing activities:		
Capital expenditures	(29,680)	(123,359)
Net cash used in investing activities	(29,680)	(123,359)
Cash flows from financing activities:		
Net proceeds from lines of credit	18,800	--
Payments on long-term debt	(1,835)	(1,967)
Payments on capital lease obligations	(1,828)	(2,941)
Repurchase of common stock	(70,324)	(7,519)
Proceeds from sale of stock and put options	7,456	9,342
Net cash used in financing activities	(47,731)	(3,085)
Net decrease in cash and cash equivalents	(7,227)	(1,155)
Cash and cash equivalents at beginning of period	32,188	42,999
Cash and cash equivalents at end of period	\$ 24,961	\$ 41,844

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 nine months ended December 31, 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) 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 make a secondary payment, the amount of which will be determined by a formula based on the net sales and gross margin results of the Company's Keeloq product division for a six-month measurement period. Any such secondary payment is based on

future performance and is currently estimated to be between \$8,000,000 and \$15,000,000. The measurement period is the six-month period ending March 31, 1999, based upon an election which was made by the seller.

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(4) ACCOUNTS RECEIVABLE

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

	December 31, 1998	March 31, 1998
	-----	-----
	(unaudited)	
Trade accounts receivable	\$ 58,294	\$ 57,922
Other	421	790
	-----	-----
	58,712	58,712
Less allowance for doubtful accounts	2,509	2,392
	-----	-----
	\$ 56,206	\$ 56,320
	=====	=====

(5) INVENTORIES

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

	December 31, 1998	March 31, 1998
	-----	-----
	(unaudited)	
Raw materials	\$ 4,852	\$ 5,795
Work in process	47,277	40,000
Finished goods	30,906	30,021
	-----	-----
	83,035	75,816
Less allowance for inventory valuation	10,926	9,523
	-----	-----
	\$ 72,109	\$ 66,293
	=====	=====

(6) PROPERTY, PLANT AND EQUIPMENT

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

	December 31, 1998	March 31, 1998
	-----	-----
	(unaudited)	
Land	\$ 11,545	\$ 11,749
Building and building improvements	78,570	59,725
Machinery and equipment	371,941	322,624
Projects in process	41,173	82,528
	-----	-----
	503,229	476,626
Less accumulated depreciation and amortization	196,635	150,734
	-----	-----
	\$ 306,594	\$ 325,892
	=====	=====

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(7) 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 (5.624% at December 31, 1998) plus .325%, expiring in October 2000. At December 31, 1998 and at March 31, 1998, the Company had utilized \$28,000,000 and \$7,000,000, respectively, 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 December 31, 1998.

The Company has an additional unsecured line of credit with various Taiwan financial institutions for up to \$32,800,000 (U.S. Dollar equivalent). These borrowings are predominantly denominated in New Taiwan Dollars, bearing interest at SIBOR (5.125% at December 31, 1998) plus 0.60%, and expiring on various dates through November 1999. At December 31, 1998 and March 31, 1998 the Company had utilized \$13,800,000 and \$16,000,000, respectively, of this line of credit.

(8) STOCKHOLDERS' EQUITY

STOCK PURCHASE AND OPTION ACTIVITY. As of March 31, 1998, the Company held 1,010,953 shares in treasury stock. During the nine months ended December 31, 1998, the Company's Board of Directors authorized the purchase of up to 4,000,000 shares of Common Stock and the sale of put options covering an additional 500,000 shares of Common Stock. In connection with the stock purchase program, during the nine months ended December 31, 1998, the Company purchased a total of 2,847,500 shares of the Company's Common Stock in open market activities at a total cost of \$70,324,000. For the nine month period ended December 31, 1998, the Company had reissued 958,942 of purchased shares through stock option exercises, the Company's employee stock purchase plan and settlements related to the Company's net share settled forward contract. As of December 31, 1998, the Company held 3,230,086 shares in treasury stock.

Also in connection with the stock purchase program, during the nine months ended December 31, 1998, the Company sold put options covering 500,000 shares of Common Stock at prices ranging from \$22.30 to \$23.75 per share. During the nine months ended December 31, 1998, the Company purchased put options for 100,000 shares. The net proceeds from the sale and purchase of such put options, in the amount of \$2,231,000 for the nine months ended December 31, 1998, were charged to additional paid-in capital. As of December 31, 1998, the Company had outstanding put options covering 850,000 shares of Common Stock which have expiration dates ranging from January 29, 1999 to September 13, 1999, at prices ranging from \$22.30 to \$37.88 per share.

Also in connection with the stock purchase program, during the nine months ended December 31, 1998, the Company completed a costless collar transaction involving the purchase of call options covering 500,000 shares of Common Stock priced at \$25.95 and the sale of put options covering 665,000 shares of Common Stock priced at \$25.19. The expiration date of the transaction is April 1999. Also in connection with the stock purchase program, during the nine months ended December 31, 1998, 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.

The Company expects from time to time to purchase shares of Common Stock in connection with its authorized stock purchase program.

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(9) NET INCOME PER SHARE

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

<TABLE>
<CAPTION>

	Three Months Ended		Nine Months Ended	
	December 31, (Unaudited)		December 31, (Unaudited)	
	1998	1997	1998	1997
<S>	<C>	<C>	<C>	<C>
Net income	\$17,854	\$13,127	\$48,191	\$50,141
Weighted average common shares outstanding	50,647	53,762	51,422	53,362
Dilutive effect of stock options	2,545	3,060	2,397	3,195
Weighted average common and common equivalent shares outstanding	53,192	56,822	53,819	56,557
Basic net income per share	\$ 0.35	\$ 0.24	\$ 0.94	\$ 0.94
Diluted net income per share	\$ 0.34	\$ 0.23	\$ 0.90	\$ 0.89

</TABLE>

(10) 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. The Company has no transactions involving non-owner sources.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION AND FOURTH QUARTER OUTLOOK

The current environment in the semiconductor industry continues to be characterized by flat to negative sales growth, extremely low order visibility and declining inventory levels at customers and throughout the distribution channel. Over the past twelve months Microchip's sales in dollars have remained relatively flat overall, while the Company has experienced moderate growth in its core 8-bit microcontroller product line and has continued to gain market share in that market. Microchip anticipates an industry-wide return to growth during the second half of this calendar year and has taken a variety of measures to optimally position the Company for such an upturn.

The Company has decided to implement two restructuring actions to position the Company for future cost effective growth. During the March 1999 quarter, the Company will complete closure of its 5-inch wafer line which represents the Company's least flexible and least cost-effective productive capacity. In eliminating the 5-inch production capacity, the Company's productive capacity will be reduced by approximately 20%. The Company intends to replace this capacity with 6-inch and 8-inch wafer production, but intends to delay this action until inventories have been reduced in both net dollars and days' sales of inventories. The Company also plans to restructure its assembly and test operations over the next two quarters, migrating more of its test and a portion of its assembly to lower-cost, Company-owned facilities. Based on these two restructuring actions, the Company expects to incur a special restructuring charge in the March 1999 quarter of \$15 to \$17 million.

Additionally, as indicated in Footnote (3) in the Notes to Condensed Consolidated Financial Statements, under the terms of the Keeloq Acquisition, the Company expects to make the final acquisition payment based upon the performance of the Company's Keeloq(R) products during the measurement period ending March 31, 1999. This payment is currently estimated to be between \$8 million and \$15 million.

THE FOREGOING STATEMENTS RELATING TO ANTICIPATED INDUSTRY-WIDE RETURN TO GROWTH, THE COMPANY'S POSITIONING FOR AN INDUSTRY-WIDE UPTURN, THE AMOUNT OF RESTRUCTURING CHARGES FOR THE QUARTER ENDING MARCH 31, 1999 AND THE AMOUNT OF THE FINAL PAYMENT FOR THE KEELOQ ACQUISITION ARE FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS; MARKET CONDITIONS IN THE SEMICONDUCTOR INDUSTRY AND DEMAND FOR THE COMPANY'S PRODUCTS; DELAY IN THE FACILITATION OF THE COMPANY'S IN-HOUSE ASSEMBLY AND TEST OPERATIONS; FLUCTUATIONS IN PRODUCTION YIELDS AND PRODUCTION EFFICIENCIES; OVERALL CAPACITY UTILIZATION; COST AND AVAILABILITY OF RAW MATERIALS; ABSORPTION OF FIXED COSTS, LABOR AND OTHER DIRECT MANUFACTURING COSTS; CHANGES IN PRODUCT MIX; AND SALES OF KEELOQ(R)-RELATED PRODUCTS DURING THE SIX MONTHS ENDING MARCH 31, 1999.

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RESULTS OF OPERATIONS

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

	Three Months Ended		Nine Months Ended	
	December 31, 1998	December 31, 1997	December 31, 1998	December 31, 1997
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	49.4%	51.9%	50.1%	50.2%
Gross profit	50.6%	48.1%	49.9%	49.8%
Research and development	10.1%	9.7%	10.2%	9.4%
Selling, general and administrative	15.4%	16.6%	15.7%	16.7%
Special charge	--	4.8%	1.8%	1.6%
Operating income	25.1%	17.0%	22.2%	22.1%

For 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 December 31, 1998 were \$100.2 million, a decrease of 3.3% over sales of \$103.6 million for the corresponding quarter of the previous fiscal year, and a decrease of 3.5% from

the previous quarter's sales of \$103.8 million. Net sales for the nine months ended December 31, 1998 were \$303.4 million, flat with sales of \$303.8 million in the corresponding period of the previous fiscal year.

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 76% and 67% of net sales in the three months ended December 31, 1998 and 1997, respectively. A related component of the Company's product sales consists primarily of Serial EEPROM memories which accounted for 24% and 33% of net sales in the three months ended December 31, 1998 and 1997, respectively. Microcontroller and associated application development systems accounted for 75% and 68% of net sales in the nine months ended December 31, 1998 and 1997, respectively, while the related component consisting of primarily Serial EEPROM memories accounted for 25% and 32%, respectively, for the same periods.

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. As part of its competitive strategy, the Company has emphasized its ability to respond quickly to such turns orders. 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 its business over the last several years and is 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

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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 and the first nine months 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 the Company 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. 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. 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; 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.

Foreign sales represented 71.0% of net sales in both the three months ended December 31, 1998 and 1997 and 68.0% and 70.0% for the nine months ended December 31, 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.

ADDITIONAL FACTORS AFFECTING OPERATING RESULTS

The Company believes that future growth in net sales of its 8-bit microcontrollers and other related 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 substantial numbers of application development systems. 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

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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 semiconductor industry is a capital intensive business and the Company's operating results may be adversely affected if net sales are not sufficient to offset the high fixed manufacturing costs and operating expenses. 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 \$50.6 million and \$49.8 million in the three months ended December 31, 1998 and 1997, respectively, and \$151.4 million and \$151.3 million in the nine months ended December 31, 1998 and 1997, respectively. Gross profit as a percent of sales was 50.6% and 48.1% in the three months ended December 31, 1998 and 1997, respectively, and 49.9% and 49.8% in the nine months ended December 31, 1998 and 1997, respectively. Gross margins improved during the quarter ended December 31, 1998, influenced primarily by improved product mix between microcontrollers and Serial EEPROMS and the Company's ongoing cost reduction programs. The Company anticipates that its gross product margins will fluctuate over time, driven primarily by the product mix of 8-bit microcontroller products and related memory products, wafer fab loading levels, ongoing cost reduction efforts, manufacturing yields and competitive and economic conditions.

During the quarter ended December 31, 1998, the Company reduced the manufacturing levels of its 5-inch wafer fab by approximately 30%. The Company also completed a longer than normal holiday shutdown of its wafer fabrication facilities at the end of December 1998. The Company intends to eliminate its 5-inch wafer line by the end of the current fiscal quarter, primarily due to the higher cost and lower manufacturing flexibility of this production line. The Company intends to replace this capacity with 6-inch and 8-inch wafer production, but intends to delay this action until inventories have been reduced in both net dollars and days' sales of inventories. The Company also plans to restructure its assembly and test operations over the next two quarters.

In order to offset the adverse cost absorption effects related to the elimination of the 5-inch wafer fab, the Company has instituted a series of cost reductions in all aspects of its business. There can be no assurance that these restructuring actions and cost reductions will sufficiently reduce fixed manufacturing costs to enable the Company to maintain gross profit margins. In addition, these restructuring actions could result in execution problems and manufacturing yield problems that could adversely impact the Company's gross profit.

THE FOREGOING STATEMENTS RELATING TO ANTICIPATED GROSS PRODUCT MARGIN, CLOSURE OF THE COMPANY'S 5-INCH WAFER PRODUCTION LINE, AND THE EXTENT AND IMPACT OF OPERATING EXPENSE REDUCTIONS ARE FORWARD-LOOKING STATEMENTS. 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; DEMAND FOR THE COMPANY'S PRODUCTS; COMPETITION AND

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COMPETITIVE PRESSURE ON PRICING; THE IMPACT OF COST REDUCTIONS AND THE POSSIBLE NEED FOR FURTHER COST REDUCTIONS; CHANGES IN PRODUCT MIX; AND OTHER ECONOMIC CONDITIONS.

All of Microchip's assembly operations are currently 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. Microchip intends to develop its own in-house assembly operations over the next twelve months, and will transition a portion of its assembly requirements from third-party contractors to fill this capacity. The Company currently performs test operations at Company-owned facilities in Taiwan and Thailand.

THE FOREGOING STATEMENT RELATED TO THE COMPANY'S INTENTION TO DEVELOP IN-HOUSE ASSEMBLY AND TEST OPERATIONS OVER THE NEXT 12 MONTHS IS A FORWARD-LOOKING STATEMENT. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: TIMING AND SUCCESS OF THE TRANSITION FROM THIRD PARTY ASSEMBLY SERVICES PROVIDERS TO COMPANY-OWNED ASSEMBLY AND TEST OPERATIONS; DELAY IN THE FACILITATION OF THE COMPANY'S IN-HOUSE ASSEMBLY AND TEST OPERATIONS; DIFFICULTIES IN THE TRANSITION OF THE ASSEMBLY FUNCTION FROM THIRD PARTIES TO THE COMPANY; SUPPLY DISRUPTION; LABOR UNREST; CHANGES IN PRODUCT MIX; COMPETITIVE PRESSURES ON PRICES AND OTHER ECONOMIC CONDITIONS.

The Company's reliance on third-party and Company-owned facilities in Taiwan, Thailand, the Philippines and other foreign countries, and maintenance of substantially all of its finished goods 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 1.3% in the current quarter as compared to the corresponding quarter of the previous fiscal year, and decreased by 4.1% from the previous quarter as a result of the Company's ongoing cost reduction programs. The Company will continue to invest in research and development in the future, including an investment in process and product development.

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.

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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 reduced its level of selling, general and administrative costs to \$15.4 million in the current quarter compared to \$16.2 million in the immediately preceding quarter. This decrease resulted from the Company's ongoing cost reduction programs. On slightly lower net sales, selling, general and administrative costs were lower in the current quarter by \$1.8 million, as compared to the corresponding quarter of the previous fiscal year. 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 was maintained at the same level for the three months ended December 31, 1998, as compared to the prior fiscal quarter and decreased from the corresponding quarter of the previous fiscal year as a result of reduced invested cash balances. Interest expense in the three months ended December 31, 1998 increased over the three months ended December 31, 1997, due to incremental borrowing levels associated with the stock repurchase program. Interest expense in the three months ended December 31, 1998 decreased from the prior fiscal quarter due to lower borrowings on the Company's lines of credit. 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

Provision 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% in each of the nine months ended December 31, 1998 and 1997, due to the combination of U.S. statutory taxes and 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. 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 ISSUE

The Year 2000 ("Y2K") issue is the result of various computer programs being written using two digits rather than four to define the year, thus potentially rendering them incapable of properly managing and manipulating data that includes 21st century dates. The potential for Y2K issues which could reasonably affect the Company could arise from any combination of: a) the Company's own internal information processing and embedded systems, b) external

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systems used by providers of critical goods or services to the Company, c) customer failures resulting from Y2K problems leading to reductions in demand from the customer and d) Y2K issues arising within the products manufactured by the Company.

THE COMPANY'S CURRENT STATE OF YEAR 2000 READINESS

The Company has implemented a Y2K readiness program and has, as of December 31, 1998, taken substantial efforts to reasonably insure that its operations are not subject to substantial adverse Y2K-related impact. This program began in 1997 with a comprehensive documentation of potential sources of Y2K exposure which could reasonably impact the Company's business. This initial source identification phase has been completed.

The subsequent step in the program has been to systematically analyze each identified potential source of Y2K exposure as to its likelihood of material effect on the Company's operations and the range of available remediation actions. In the case of identified systems INTERNAL to the Company, analysis generally involved performing physical tests which simulated performance of the systems with post-year 2000 dates. For potential sources of Y2K risk which are EXTERNAL to the Company, such as with the Company's external vendors and suppliers, the Company has typically relied upon written assurances of Y2K compliance from those various parties in lieu of physical testing by the Company's employees. To date, the Company has not identified any Y2K issues inherent in the products manufactured by the Company. The Company's products, for the most part, involve hardware integrated circuits which, at the time of sale to customers, have no inherent date sensitive features. The analysis phase of the Y2K readiness program has been substantially completed.

The final phase of the Y2K readiness program involves the modification, replacement or elimination of systems identified in the prior analysis phase as being in need of remediation. To date, the Company has completed the remediation process for the majority of its identified INTERNAL systems, with the primary effort centered around the total replacement of information systems related to the Company's sales order process, planning, physical distribution and finance functions. The majority of this task was completed during the quarter ended September 30, 1998. As of December 31, 1998, the Company has received letters of Y2K compliance from approximately 80% of its key EXTERNAL vendors and suppliers and expects to secure documentation of compliance from the remainder of these key vendors and suppliers by September 30, 1999.

COSTS TO ADDRESS THE YEAR 2000 ISSUE

The total cost associated with required modifications to become Y2K compliant is not expected to be material to the Company's financial position. The amount expended through December 31, 1998 was approximately \$14,000,000, primarily associated with the total replacement of the information systems related to the Company's sales order process, planning, physical distribution and finance functions which was completed during the quarter ended September 30, 1998. The Company had intended to replace such systems in the ordinary course of its business and the implementation was not substantially accelerated due to the Y2K issue. The Company believes that the cost of its Y2K readiness program, as well as currently anticipated costs to be incurred with respect to Y2K issues of third parties, will not exceed \$18,000,000, inclusive of the costs described above. It is anticipated that all such expenditures will be funded from operating cash flows and absorbed as part of the Company's ongoing operations.

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MOST REASONABLY LIKELY WORST CASE SCENARIO(S)

Having reasonably determined that the Company's own hardware and software systems will be substantially Y2K compliant and that its products inherently have no date code-related issues, management believes that the worst case scenarios would most likely involve massive, simultaneous Y2K-related disruptions from the Company's key external raw material suppliers and/or service providers. For these worst case scenarios to have maximum adverse impact on the Company, the vendors in question would either need to be sole-source providers or their peer companies, who would otherwise be potential second-source suppliers, would also need to undergo similar Y2K-related disruption. Examples on the material supplier side would include extended and substantial disruptions of the Company's key raw material suppliers of: silicon wafers, leadframes, specialty chemicals and gasses. Examples on the service provider side would include extended, substantial disruptions of the Company's third-party semiconductor assembly firms, telecommunications and datacommunications services, airfreight and delivery services, or the worldwide banking system. Examples on the customer side would include Y2K problems encountered by such customer adversely impacting that customer's business and reducing the customer's purchases from the Company. The Company believes that such massive and simultaneous disruptions of the supply of basic goods and services due to Y2K-related issues are highly unlikely to occur.

CONTINGENCY PLANS

The Company has made no contingency plans for handling Y2K issues because it believes that the steps it has taken to assess its own hardware and software systems and those of its key vendors and suppliers are adequate to ensure minimal disruption to its business processes. In the event of random, unforeseen Y2K problems (such as the failure of specific pieces of process equipment, or the temporary inability of certain vendors to provide materials or services) the Company believes that these types of issues will most likely be able to be resolved in the normal course of business, including the potential use of alternate suppliers, in most cases.

THE FOREGOING STATEMENTS RELATED TO MATERIALITY OF Y2K COSTS, THE COSTS TO ADDRESS Y2K ISSUES AND THE FUNDING AND ABSORPTION OF SUCH COSTS, WORST-CASE SCENARIO(S) AND CONTINGENCY PLANS ARE FORWARD LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY BECAUSE OF THE FOLLOWING FACTORS, AMONG OTHERS: THE FAILURE TO CORRECTLY TIMELY IDENTIFY AND CORRECT Y2K PROBLEMS, EITHER BY THE COMPANY OR ITS KEY SUPPLIERS OR CUSTOMERS.

EURO CONVERSION ISSUES

The Company operates in the European Market and currently generates approximately 30% of its net sales from customers located in Europe. The Company's commercial headquarters in Europe are located in the United Kingdom, which is not currently one of the eleven member states of the European Union who are converting to a common currency.

The Company currently conducts 96% of its business in Europe in U.S. Dollars and 2% of its business in Europe in Pounds Sterling. The balance of its net sales are conducted in currencies which will eventually be replaced by the euro. The Company will be monitoring the potential commercial impact of converting a portion of its current business to the euro, but does not expect any material impact to its business based on this transition.

The Company does not currently anticipate any material impact to its business related to euro matters from information technology, derivative transactions, tax issues and accounting software issues.

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LIQUIDITY AND CAPITAL RESOURCES

The Company had \$25.0 million in cash and cash equivalents at December 31, 1998, a decrease of \$7.2 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 December 31, 1998 were \$28.0 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 December 31, 1998. The Company also has an unsecured short-term line of credit totaling \$32.8 million with certain foreign banks. Borrowings under the foreign line of credit as of December 31, 1998 were \$13.8 million. There are no covenants related to the foreign line of credit. At December 31, 1998, an aggregate of \$81.0 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 nine months ended December 31, 1998, the Company generated \$70.2 million of cash from operating activities, a decrease of \$55.1 million from the nine months ended December 31, 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.

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 nine months ended December 31, 1998 and 1997 were \$29.7 million and \$123.4 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 \$70.0 million during the next 12 months for additional capital equipment to increase capacity at its existing wafer fabrication facilities to expand product test operations and to develop in-house assembly capacity. 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 manufacturing capacity to meet its currently anticipated needs.

Net cash used in financing activities was \$47.7 million for the nine months ended December 31, 1998. Net cash used in financing activities was \$3.1 million for the nine months ended December 31, 1997. Proceeds from sale of stock and put options were \$7.5 million and \$9.3 million for the nine months ended December 31, 1998 and 1997, respectively. Payments on long term debt and capital lease obligations were \$3.7 million and \$4.9 million for the nine months ended December 31, 1998 and 1997, respectively. Proceeds from lines of credit were \$18.8 million for the nine months ended December 31, 1998. Cash expended for the purchase of the Company's Common Stock was \$70.3 million for the nine months ended December 31, 1998.

During the nine months ended December 31, 1998, the Company purchased 2,847,500 shares of Common Stock at an aggregate cost of \$70,324,000 and had outstanding 850,000 put options at prices ranging from \$22.30 to \$37.88. The Company also has a costless collar and a net share settled forward contract. See Note 8 to "Condensed Consolidated Financial Statements." 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.

The Company expects from time to time to purchase shares of Common Stock in connection with its authorized common stock purchase plan. The Company

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will also have cash requirements associated with the restructuring activities described above and the secondary payment related to the Keeloq Acquisition.

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.

PART II. OTHER INFORMATION

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 December 31, 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: February 12, 1999

By: /s/ C. Philip Chapman

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

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