FINANCIAL HIGHLIGHTS

Twelve months ended December 31,

(In millions, except per share data)	1992	1993[1]	1994[1]	1995[1]	**1996**
Consolidated Statement of Income Data:					
Net revenues	$ 1,568.1	$ 2,037.5	$ 2,644.9	$ 3,554.4	**$ 4,122.4**
Cost of sales[2]	(1,051.6)	(1,248.4)	(1,528.7)	(2,096.0)	**(2,414.7)**
Gross profit[2]	516.5	789.1	1,116.2	1,458.4	**1707.7**
Total operating expenses[3]	(464.7)	(573.6)	(683.2)	(807.4)	**(908.3)**
Operating income[4]	51.8	215.5	433.0	651.0	**799.4**
Net interest expenses/other[5]	(46.5)	(37.8)	(21.0)	(16.8)	**(3.9)**
Profit before tax	5.3	177.7	412.0	634.2	**795.5**
Income tax expense	(2.3)	(17.6)	(49.5)	(108.3)	**(171.6)**
Income before minority interests	3.0	160.1	362.5	525.9	**623.9**
Minority interests[6]	0	0	0	0.6	**1.6**
Net income[7]	$ 3.0	$ 160.1	$ 362.5	$ 526.5	**$ 625.5**
Earnings per share[8]	$ 0.06	$ 1.92	$ 3.04	$ 4.03	**$ 4.50**
Weighted average shares outstanding	53.6	83.5	119.4	130.6	**138.7**
Consolidated Balance Sheet Data (end of period):					
Cash, cash equivalents and marketable securities	$ 99.5	$ 327.4	$ 461.5	$ 758.4	**$ 556.4**
Working capital	467.7	390.0	291.1	417.4	**611.8**
Total assets	1,842.3	2,240.9	3,224.7	4,486.0	**5,005.5**
Short-term debt					
(including current portion of long-term debt)	360.6	231.1	322.5	492.8	**428.2**
Long-term debt (excluding current portion)[1]	547.6	374.8	277.2	200.7	**194.9**
Shareholders' equity[1]	412.9	1,004.0	1,680.0	2,661.7	**3,260.0**

(1) In October 1995, the Company completed a second public offering with net proceeds to the Company of approximately $371.6 million. In December 1994, the Company completed an Initial Public Offering with net proceeds to the Company of approximately $198.7 million. In 1993, the Company received a $500 million capital contribution that was effected in two steps, $250 million in May and $250 million in September. The Company also received a $100 million capital contribution in each of 1988, 1989 and 1991.

(2) Cost of sales is net of certain third-party funding for industrialization costs (which include certain costs incurred to bring prototype products to the production stage) included therein. See Note 19 to the Consolidated Financial Statements. For a discussion of certain significant charges reflected in cost of sales in 1994, 1995 and 1996, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations."

(3) Includes, among other things, third-party funding for research and development, the expenses for which are reflected in research and development expenses, as well as foreign currency gains and losses, fab start-up costs, patent license payments received and patent costs incurred. The Company's reported research and development expenses do not include design center, process engineering, pre-production or industrialization costs.

(4) The Company has changed the title of this line item from "operating profit." The make-up of this line item has not changed.

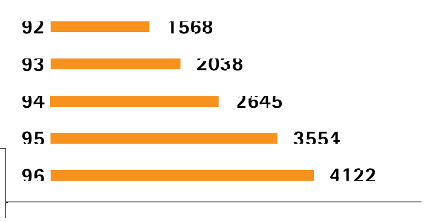
(5) Includes mainly net interest expenses, plus a gain on disposal of an investment in 1992 and 1996.

(6) In 1994, the Company created a joint venture with a subsidiary of the Shenzhen Electronics Group ("SEG"). the Company owns a 60% interest in the joint venture, with a subsidiary of SEG owning the remaining 40%.

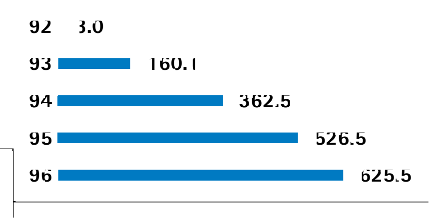
(7) The Company has changed the title of this line item from "net earnings." The make-up of this line item has not changed.

(8) Net earnings per share amounts have been restated to reflect a 40:1 stock split effected in connection with the Initial Public Offering.

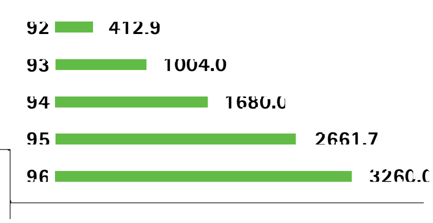
Net Revenues
($US Millions)

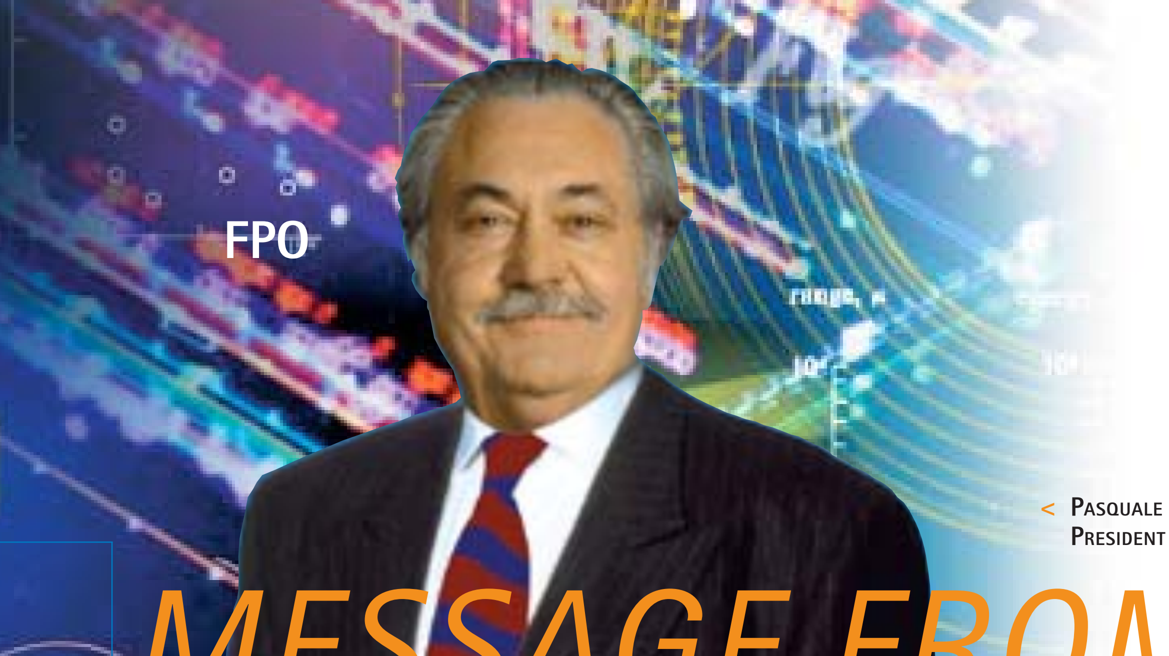


Net Income
($US Millions)



Shareholders' Equity
($US Millions)





< Pasquale Pistorio
President and Chief Executive Officer

MESSAGE FROM THE PRESIDENT

SGS-THOMSON distinguished itself in 1996 by achieving consistent performance within a volatile semiconductor marketplace. The Company surpassed the $4 billion mark in net revenues, and both sales and profits increased at rates that outpaced the industry average and the served markets. We also maintained our market leadership in a variety of high growth applications, while at the same time investing in the future via a well-focused research and development effort.

Our ability to continue the Company's profitable growth in spite of a difficult market cycle was a direct reflection of SGS-THOMSON's established strategies of maintaining a high proportion of differentiated products, forming close alliances with major customers, and creating a balanced business mix by application and geography. It is also a tribute to a talented and dedicated team of people worldwide.

> 1996 Financial Highlights

Net revenues for 1996 were a record $4.12 billion, an increase of 16% from 1995's results. Gross profit for the year amounted to $1.70 billion, increasing 17% year over year. This represented a gross margin of 41.4% of net revenues for 1996, compared with 41.0% in 1995. Operating income for the year increased 23% to $799.4 million. Expressed as a percentage of net revenues, the operating profit margin rose to 19.4% for the past year, versus 18.3% in 1995.

Net income for 1996 advanced 19% to $625.5 million, compared to $526.5 million for 1995. Earnings per share rose nearly 12% to $4.50, based on 138.7 million weighted average shares outstanding. The corresponding 1995 figure was $4.03 per share, based upon 130.6 million weighted average shares outstanding.

Due to our emphasis on differentiated products, focus on high growth applications, and breadth of geographic markets, 1996 clearly was a successful year for SGS-THOMSON from the perspective of overall sales and profitability. I should note that our rate of growth slowed in the latter part of the year due to the industry downturn. Also, our gross margin decreased to 38% in the fourth

“OUR PROFITABLE GROWTH REFLECTED SGS-THOMSON’S ESTABLISHED STRATEGIES TO FOSTER DIFFERENTIATED PRODUCTS, CLOSE ALLIANCES WITH CUSTOMERS, AND A BALANCED BUSINESS MIX.”

quarter, which was within the expected range for this phase of the industry cycle, but nonetheless was below the strong levels of the past several quarters. This was partly due to the under-utilization of our non-VLSI fabs and a temporary reduction in output from Phoenix while we qualified that facility for additional manufacturing activities. The Company also experienced pricing pressures, especially on the commodity portion of our portfolio. We expect utilization at the non-VLSI fabs and Phoenix to improve as we move into 1997. However, we continue to see pricing pressure in the commodity area, and are thus maintaining cautious expectations for margins at least through the first quarter of the new year.

One of the ways in which we have responded to the challenging market conditions is by intensifying our control of operating costs. Total operating expenses were reduced as a percent of net revenues to 22.0% in 1996 from 22.7% in 1995, even though we continued to increase research and development expenses to support our technological leadership. Expenses also declined in absolute terms in the fourth quarter as compared with the year-ago period.

With confidence in the long-term prospects for our industry, we continued to invest in the growth of the Company. Last year, capital expenditures totalled $1.12 billion, compared with $1.00 billion in 1995. Research and development expenses increased by 21% to $532.3 million in 1996, and represented 12.9% of net revenues.

SGS-THOMSON finished the year with a sound balance sheet. At the end of 1996, cash, cash equivalents and marketable securities totaled $556.4 million. Total debt was $623.1 million, including $194.9 million of long-term debt, while net debt stood at $66.7 million. With shareholders’ equity of $3.26 billion, our ratio of net debt-to-equity was a conservative 0.02.

> Operating Performance

The developments of 1996 clearly show that SGS-THOMSON has been the beneficiary of strategies to spur the growth of differentiated products and to create solid alliances with key customers. Differentiated products, which we define as dedicated/ASSPs, semicustom integrated circuits and microcontrollers, accounted for 58.6% of net revenues in 1996, compared to 51.5% in 1995. For the fourth quarter, differentiated products were a record 61.3% of net revenues, in spite of capacity constraints in our leading-edge, submicron technologies. The growth in differentiated products more than offset decreases in sales of commodity linear and discrete products. Further, we derived approximately 31% of our net revenues from significant customers with whom we have strategic alliances. Revenues generated by such alliances rose 36.5% over 1995. The stability produced by our strategic alliances also helped balance the industry-wide pressure on commodity business.

Our net revenues for 1996 were well-balanced from the perspective of applications. Consumer applications sales were up 26.4%, and accounted for 22.1% of net revenues. Sales of products used in the automotive market rose 20.4%, and represented 9.6% of the total. Business with the computer sector increased 13.8%, to reach 26.7% of net revenues. Sales of products for telecommunications applications increased 14.0%, representing 22.1% of net revenues. In the industrial area, sales rose at a rate of 8.8%, and were 19.6% of net revenues for the year.

Revenues from all major geographic regions advanced over the previous year, and outperformed the growth rates of the respective markets. Our North American sales posted a 10.4% increase for 1996, while the overall market decreased an estimated 9.2%. In the Asia/Pacific our sales were up 22.8%, versus a 6.7% decline for the region. SGS-THOMSON's sales in Europe rose 12.1%, compared with a 2.3% market decrease. Our Japan business enjoyed 46.8% sales growth, versus a 13.8% decrease for the region as a whole. As a percentage of net revenues, Europe represented 44.3%, North America 22.7%, Asia/Pacific 27.5% and Japan 5.5% for the year. Including products sold to the Asian operations of U.S. customers, North America represented more than 30% of net revenues.

> Semiconductor Market Perspective

As I noted earlier, SGS-THOMSON's financial and operational progress during 1996 was achieved against the backdrop of a volatile semiconductor market environment. I would like to take this opportunity to provide an overview of the industry conditions that prevailed during much of the past year, and those that are expected to have an effect on our results in 1997. Please note that this is a general assessment, and that the timing of market phases may vary from our model by a quarter or two.

We believe there are four phases to the present market cycle. Phase I began in approximately the third or fourth quarter of 1995, and was marked by some overcapacity in certain commodity products, particularly DRAMs. While we do not manufacture such products, and thus were not seriously affected by the first phase, other producers suffered from price pressures.

Phase II began in the 1996 second and third quarters, characterized by an inventory liquidation period with prices falling more rapidly in response to very substantial over-supply. Again, the majority of the pricing pressure took place in commodity categories. Competitors in the most affected segments of the industry were obliged to adjust by liquidating inventory, cutting production and reducing employment.

"REVENUES WERE WELL-BALANCED FROM THE PERSPECTIVE OF APPLICATIONS, AND ALSO OUTPERFORMED THE GROWTH RATES OF OUR REGIONAL MARKETS."

SELECTED CONSOLIDATED FINANCIAL DATA

The table below sets forth selected consolidated financial data for the Company for each of the years in the five-year period ended December 31, 1996. Such data have been derived from the consolidated financial statements of the Company. Consolidated financial statements for the three-year period ended December 31, 1996, are included elsewhere in this annual report.

The following information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and the related notes thereto included elsewhere in this annual report.

	Twelve months ended December 31,				
(In millions except per share data)	1992	1993 (1)	1994 (1)	1995 (1)	**1996**
CONSOLIDATED STATEMENT OF INCOME DATA:					
Net sales	$ 1,550.6	$ 2,007.7	$ 2,602.2	$ 3,520.7	**$ 4,078.3**
Other revenues	17.5	29.8	42.7	33.7	**44.1**
Net revenues	1,568.1	2,037.5	2,644.9	3,554.4	**4,122.4**
Cost of sales(2)	(1,051.6)	(1,248.4)	(1,528.7)	(2,096.0)	**(2,414.7)**
Gross profit(2)	516.5	789.1	1,116.2	1,458.4	**1,707.7**
Operating expenses:					
Selling, general and administrative	(270.0)	(302.5)	(339.9)	(413.2)	**(421.1)**
Research and development(3)	(260.9)	(270.9)	(338.3)	(440.3)	**(532.3)**
Restructuring costs	(38.9)	(49.9)	(37.0)	(13.0)	**0.0**
Other income and expenses(3)	105.1	49.7	32.0	59.1	**45.1**
Total operating expenses	(464.7)	(573.6)	(683.2)	(807.4)	**(908.3)**
Operating income(4)	51.8	215.5	433.0	651.0	**799.4**
Net interest expenses	(65.2)	(37.8)	(21.0)	(16.8)	**(11.2)**
Gain on disposal of investment	18.7	0.0	0.0	0.0	**7.3**
Income before income taxes and minority interests	5.3	177.7	412.0	634.2	**795.5**
Income tax expense	(2.3)	(17.6)	(49.5)	(108.3)	**(171.6)**
Income before minority interests	3.0	160.1	362.5	525.9	**623.9**
Minority interests(5)	0.0	0.0	0.0	0.6	**1.6**
Net income(6)	$ 3.0	$ 160.1	$ 362.5	$ 526.5	**$ 625.5**
Earnings per share(7)	$ 0.06	$ 1.92	$ 3.04	$ 4.03	**$ 4.50**
Number of weighted average shares used in calculating earnings per share	53.6	83.5	119.4	130.6	**138.7**
CONSOLIDATED BALANCE SHEET DATA (END OF PERIOD):					
Cash, cash equivalents and marketable securities	$ 99.5	$ 327.4	$ 461.5	$ 758.4	**$ 556.4**
Working capital	467.7	390.0	291.1	417.4	**611.8**
Total assets	1,842.3	2,240.9	3,224.7	4,486.0	**5,005.5**
Short-term debt (including current portion of long-term debt)	360.6	231.1	322.5	492.8	**428.2**
Long-term debt (excluding current portion)(1)	547.6	374.8	277.2	200.7	**194.9**
Shareholders' equity(1)	412.9	1,004.0	1,680.0	2,661.7	**3,260.0**
CONSOLIDATED OPERATING DATA:					
Capital expenditures(8)	$ 196.0	$ 445.9	$ 779.7	$ 1,001.9	**$ 1,125.2**
Net cash from operating activities	198.7	460.9	728.1	825.1	**980.7**
Depreciation and amortization(8)	209.8	229.4	288.0	392.4	**535.9**

(1) In October 1995, the Company completed a second public offering with net proceeds to the Company of approximately $371.6 million. In December 1994, the Company completed an Initial Public Offering with net proceeds to the Company of approximately $198.7 million. In 1993, the Company received a $500 million capital contribution that was effected in two steps, $250 million in May and $250 million in September. The Company also received a $100 million capital contribution in each of 1988, 1989 and 1991.

(2) Cost of sales is net of certain third-party funding for industrialization costs (which include certain costs incurred to bring prototype products to the production stage) included therein. See Note 19 to the Consolidated Financial Statements. For a discussion of certain significant charges reflected in cost of sales in 1994, 1995 and 1996, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations."

(3) Other income and expenses include, among other things, third-party funding for research and development, the expenses for which are reflected in research and development expenses, as well as foreign currency gains and losses, fab start-up costs, patent license payments received and patent costs incurred. The Company's reported research and development expenses do not include design center, process engineering, pre-production or industrialization costs.

(4) The Company has changed the title of this line item from "operating profit." The make-up of this line item has not changed.

(5) In 1994, the Company created a joint venture with a subsidiary of the Shenzhen Electronics Group ("SEG"). The Company owns a 60% interest in the joint venture, with a subsidiary of SEG owning the remaining 40%.

(6) The Company has changed the title of this line item from "net earnings." The make-up of this line item has not changed.

(7) Earnings per share amounts have been restated to reflect a 40:1 stock split effected in connection with the Initial Public Offering.

(8) Capital expenditures are net of certain third-party funding, the effect of which is to decrease depreciation.

OVERVIEW

The Company was formed in 1987 as a result of the combination of the non-military business of Thomson Semiconducteurs, the microelectronics business of the French state-controlled defense electronics company Thomson-CSF, and SGS Microelettronica, the microelectronics business owned by STET, the Italian state-controlled telecommunications company. Since its formation, the Company has significantly broadened and upgraded its range of products and technologies and has strengthened its manufacturing and distribution capabilities in Europe, North America and the Asia Pacific region, while at the same time restructuring its operations to improve efficiency.

From 1992 to 1996, the Company's net revenues increased from $1,568.1 million to $4,122.4 million, with the Company experiencing strong revenue growth during each year in this period. Such revenue gains were achieved despite the Company's absence during that period from the market for DRAMs (a commodity memory product) and, until the second half of 1994, from the market for personal computer microprocessors (such as the x86 family of products). According to trade association data, the TAM (total available market) increased from $59.9 billion in 1992 to a preliminary estimate of $132.0 billion in 1996, while the SAM (which prior to 1995 consisted of the TAM without DRAMs, microprocessors and opto-electronic products and commencing in 1995 and for all prior periods compared therewith includes microprocessors as a result of the Company's production of x86 products) increased from $49.0 billion in 1992 to a preliminary estimate of $102.7 billion in 1996. The Company's share of the TAM increased from 2.6% to 3.1% during this period, while the Company's share of the SAM increased from 3.2% to 4.0%. Revenue growth within the Company from 1992 through 1996 was particularly significant for dedicated products, EPROMs and semicustom devices. The Company has also succeeded in becoming a more global semiconductor supplier—the proportion of the Company's revenues derived outside Europe increased from approximately 46% in 1992 to approximately 56% in 1996.

Differentiated ICs (which the Company defines as being its dedicated products, semicustom devices and microcontrollers) accounted for approximately 59% of the Company's net revenues in 1996, compared to just over 51% in 1995. Such products foster close relationships with customers, resulting in early knowledge of their evolving requirements and opportunities to access their markets for other products, and are less vulnerable to competitive pressures than standard commodity products. In 1996, analog ICs (including mixed signal ICs), the majority of which are also differentiated ICs, accounted for approximately 46% of the Company's net revenues (no change from 1995), while discrete devices accounted for approximately 14% of the Company's net revenues (compared to approximately 17% in 1995). Over the last three years, these families of products, in particular analog ICs, have experienced less volatility in sales growth rates and average selling prices than the overall semiconductor industry.

In addition to increasing revenues, management's efforts to rationalize operations and increase manufacturing and other efficiencies have generated significant improvements in profitability. The Company's gross profit margin increased from 32.9% in 1992 to 41.4% in 1996. Benefiting from a favorable industry environment in 1993, 1994 and 1995, such increases in gross profit margins have combined with significant reductions in selling, general and administrative expenses as a percentage of net revenues and reduced interest costs to significantly increase profitability. In 1996, the gross profit margin was 41.4% compared to 41.0% in 1995. The stable gross profit margin in 1996 compared to 1995 was realized within an unfavorable industry environment (which resulted in tough pricing pressures), due primarily to a more favorable product mix and improved manufacturing productivity.

Historically, cyclical changes in production capacity in the semiconductor industry and demand for electronic systems have resulted in pronounced cyclical changes in the level of semiconductor sales and fluctuations in prices and margins for semiconductor products from time to time. However, certain significant changes in the industry could contribute to continued growth over the long term notwithstanding cyclical variations from period to period. Such changes include the development of new semiconductor applications, increased semiconductor content as a percentage of total system cost, emerging strategic partnerships and growth in the electronic systems industry in the Asia Pacific region.

The Company is entering 1997 in a healthy financial condition. It is, however, evident that the industry has started a correction from the extraordinary growth of recent years. According to preliminary estimated trade association data, in 1996 TAM revenues decreased approximately 9% over 1995 while SAM revenues increased approximately 3%. The Company cannot anticipate how deep or how long this correction phase will be. The Company is confident, however, that its heavy emphasis on differentiated products in its portfolio, its strong customer base and strategic alliances, its well diversified sales base, both in terms of applications and geography, recent contracts with key customers and new design wins in such high growth areas as hard disk drives, set top boxes and digital cellular phones should allow the Company to continue to outperform the industry average in 1997. Based on currently available information, the Company believes that the second, third and fourth quarters of 1997 will show progressive improvement compared to the first quarter of 1997.

Some of the above statements contained in this "Overview" are forward looking statements that involve a number of risks and uncertainties. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: the cyclicality of the semiconductor and electronic systems industries; capital requirements and the availability of funding; competition; new product development and technological change; manufacturing risks; order cancellations or reduced bookings by key customers or distributors; intellectual property developments, international events, currency fluctuations; problems in obtaining adequate raw materials on a timely basis; and the loss of key personnel. Unfavorable changes in the above or other factors discussed under "Risk Factors" listed from time to time in the Company's SEC reports, including in the Prospectus dated October 18, 1995 (pages 9 through 16), could materially affect the Company.

RESULTS OF OPERATIONS

The table below sets forth information on the Company's net revenues by product group and by geographic region.

	Twelve months ended December 31,				
(In millions)	1992	1993	1994	1995	**1996**
Net Revenues by Product Group:					
Dedicated Products[(1)]	$ 562.6	$ 724.1	$ 987.7	$ 1,359.7	**$1,757.7**
Discrete and Standard ICs[(2)]	432.3	514.6	636.3	838.0	**784.1**
Memory Products[(1)]	279.2	440.0	560.7	653.3	**736.8**
Programmable Products	259.9	320.4	381.4	535.3	**720.5**
Others[(3)]	34.1	38.4	78.8	168.1	**123.3**
Total	$1,568.1	$2,037.5	$2,644.9	$3,554.4	**$4,122.4**
Net Revenues by Geographic Region:[(4)]					
Europe	$ 839.7	$ 976.0	$1,219.1	$1,627.5	**$1,824.4**
Americas[(5)]	350.5	495.5	673.5	846.4	**934.1**
Asia Pacific	328.7	463.2	617.6	925.1	**1,135.7**
Japan	49.2	102.8	134.7	155.4	**228.2**
Total	$1,568.1	$2,037.5	$2,644.9	$3,554.4	**$4,122.4**

(1) 1996 revenues for the Dedicated Products Group include $5.6 million of revenues from certain foundry activities which were moved from the Memory Products Group in January 1996. Revenues for the Dedicated Products Group and the Memory Products Group have been restated for prior periods to reflect this change.

(2) Includes revenues from sales of RF products, which were moved to the Discrete and Standard ICs product group in May 1994. Revenues for the Discrete and Standard ICs group have been restated for prior years to include RF product revenues.

(3) Includes revenues from sales of subsystems and other products and from the New Ventures Group, which was created in May 1994 to act as a focal point for the Company's new business opportunities.

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

(5) Substantially all of the revenues derived from the Americas are derived from the United States.

The following table sets forth certain financial data from the Company's consolidated statements of income since 1992, expressed in each case as a percentage of net revenues:

	Twelve months ended December 31,				
	1992	1993	1994	1995	1996
Net sales	98.9%	98.5%	98.4%	99.1%	98.9%
Other revenues	1.1	1.5	1.6	0.9	1.1
Net revenues	100.0	100.0	100.0	100.0	100.0
Cost of sales	(67.1)	(61.3)	(57.8)	(59.0)	(58.6)
Gross profit	32.9	38.7	42.2	41.0	41.4
Operating expenses:					
Selling, general and administrative	(17.2)	(14.8)	(12.9)	(11.6)	(10.2)
Research and development	(16.6)	(13.3)	(12.8)	(12.4)	(12.9)
Restructuring costs	(2.5)	(2.4)	(1.4)	(0.4)	0.0
Other income and expenses	6.7	2.4	1.2	1.7	1.1
Total operating expenses	(29.6)	(28.2)	(25.8)	(22.7)	(22.0)
Operating income	3.3	10.6	16.4	18.3	19.4
Net interest expenses	(4.2)	(1.9)	(0.8)	(0.5)	(0.3)
Gain on disposal of investment	1.2	0.0	0.0	0.0	0.2
Income before income taxes and minority interests	0.3	8.7	15.6	17.8	19.3
Income tax expense	(0.1)	(0.9)	(1.9)	(3.0)	(4.2)
Income before minority interests	0.2	7.9	13.7	14.8	15.1
Minority interests	0.0	0.0	0.0	0.0	0.1
Net income	0.2%	7.9%	13.7%	14.8%	15.2%

CONSOLIDATED STATEMENTS OF INCOME

(In thousands of U.S. dollars except per share amounts)	Year ended December 31, 1994	1995	1996
Net sales	2,602,205	3,520,670	**4,078,246**
Other revenues (note 16)	42,736	33,749	**44,114**
Net revenues	2,644,941	3,554,419	**4,122,360**
Cost of sales	(1,528,694)	(2,096,039)	**(2,414,706)**
Gross profit	1,116,247	1,458,380	**1,707,654**
Selling, general and administrative	(339,858)	(413,148)	**(421,012)**
Research and development	(338,361)	(440,334)	**(532,294)**
Restructuring costs (note 18)	(37,032)	(12,975)	**0**
Other income and expenses (note 19)	31,984	59,107	**45,074**
Operating income	432,980	651,030	**799,422**
Net interest expenses (note 20)	(21,022)	(16,854)	**(11,169)**
Gain on disposal of investment	0	0	**7,263**
Income before income taxes and minority interests	411,958	634,176	**795,516**
Income tax expense (note 21)	(49,464)	(108,282)	**(171,638)**
Income before minority interests	362,494	525,894	**623,878**
Minority interests		584	**1,666**
Net income	362,494	526,478	**625,544**
Earnings per share	3.04	4.03	**4.50**
Number of shares outstanding at the end of the year	128,603,880	138,208,680	**138,985,580**
Number of weighted average shares used in calculating earnings per share	119,392,417	130,647,079	**138,695,540**

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET

(In thousands of U.S. dollars)	As at December 31, 1995	1996
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 4)	754,046	551,896
Marketable securities (note 4)	4,354	4,508
Trade accounts and notes receivable (note 5)	595,419	645,923
Inventories (note 6)	450,649	521,402
Other receivables and assets (note 7)	360,262	418,051
TOTAL CURRENT ASSETS	2,164,730	2,141,780
Intangible assets, net (note 8)	13,386	17,350
Property, plant and equipment, net (note 9)	2,299,502	2,839,932
Investments and other non-current assets (note 10)	8,388	6,450
	2,321,276	2,863,732
TOTAL ASSETS	4,486,006	5,005,512
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Bank overdrafts and current portion of long-term debt (note 14)	492,788	428,245
Trade accounts and notes payable	507,889	444,166
Other payables and accrued liabilities (note 15)	342,738	318,556
Accrued and deferred income tax	138,256	210,805
TOTAL CURRENT LIABILITIES	1,481,671	1,401,772
Long-term debt (note 14)	200,660	194,910
Reserves for pension and termination indemnities (note 12)	94,956	100,685
Other non-current liabilities (note 13)	37,462	38,224
	333,078	333,819
TOTAL LIABILITIES	1,814,749	1,735,591
MINORITY INTERESTS	9,542	9,901
Capital stock	1,066,528	1,072,933
Capital surplus	922,065	930,330
Accumulated result	584,039	1,209,738
Translation adjustments	89,083	47,019
SHAREHOLDERS' EQUITY (note 11)	2,661,715	3,260,020
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	4,486,006	5,005,512

Other commitments and contingencies: Note 25

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)	Year ended December 31, 1994	1995	1996
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	362,494	526,478	**625,544**
Add (deduct) non-cash items:			
Depreciation and amortization	287,985	392,390	**535,908**
Gain on disposal of investment	0	0	**(7,263)**
Other non-cash items	60,121	(8,707)	**7,298**
Minority interest in net income of subsidiaries	0	(584)	**(1,666)**
Changes in assets and liabilities:			
Trade receivables	(71,290)	(126,603)	**(71,774)**
Inventories	(35,031)	(91,412)	**(80,517)**
Trade payables	78,144	17,005	**(38,019)**
Other assets and liabilities, net	45,705	116,562	**11,156**
NET CASH FROM OPERATING ACTIVITIES	728,128	825,129	**980,667**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payment for purchases of tangible assets	(779,696)	(1,001,936)	**(1,125,205)**
Proceeds from sales of tangible assets and investments	1,455	0	**8,420**
Other investing activities	(5,951)	2,868	**(5,297)**
Investment in marketable debt securities (net)	59,618	5	**(196)**
NET CASH USED IN INVESTING ACTIVITIES	(724,574)	(999,063)	**(1,122,278)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	13,702	11,741	**84,623**
Repayment of long term debt	(148,554)	(96,202)	**(54,085)**
Increase (decrease) in short-term facilities	101,224	165,298	**(106,239)**
Capital increase	202,836	391,321	**16,671**
NET CASH FROM (USED IN) FINANCING ACTIVITIES	169,208	472,158	**(59,030)**
Effect of changes in exchange rates	20,936	(1,412)	**(1,509)**
NET CASH INCREASE (DECREASE)	193,698	296,812	**(202,150)**
Cash and cash equivalents at beginning of the year	263,536	457,234	**754,046**
Cash and cash equivalents at end of the year	457,234	754,046	**551,896**

The accompanying notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Currency — Thousands of U.S. dollars)

1. THE COMPANY

SGS-THOMSON Microelectronics N.V. (the "Company") was formed in 1987 by the combination of the semiconductor business of SGS Microelettronica (then owned by Società Finanziara Telefonica (S.T.E.T.), an Italian corporation) and the non-military business of Thomson Semiconducteurs (then owned by Thomson-CSF, a French corporation) whereby each company contributed their respective semiconductor businesses in exchange for a 50% interest in the Company.

The Company is registered in the Netherlands with its statutory domicile in Amsterdam.

As of December 31, 1996, the Company was 69.04% (December 31, 1995: 69.36%) owned by SGS-THOMSON Microelectronics II B.V., and 30.96% by the public (December 31, 1995: 30.64%)

At December 31, 1996, SGS-THOMSON Microelectronics II B.V. was 100% owned by SGS-THOMSON Microelectronics Holding N.V. At December 31, 1996 and at December 31, 1995, SGS-THOMSON Microelectronics Holding N.V. was owned as follows:

- 50% by FT2CI, a French holding company, whose shareholders in turn are FT1CI (50.1%) and Thomson-CSF (49.9%); FT1CI, a French holding company, is owned by CEA-Industrie (51%) and France Télécom (49%).

- 50%, (48.14% in 1993) by M.E.I.—Microelettronica Italiana s.r.l. ("M.E.I."), an Italian holding company, whose Shareholders are Comitato per l'intervento nella SIR ed in settori ad alta tecnologia ("Comitato SIR") (49.9%) and Istituto per la Ricostruzione Industriale S.p.a. (I.R.I.) (50.1%).

2. SUMMARY OF ACCOUNTING POLICIES

2.1) Principles of consolidation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP). The Company maintains its accounting records in accordance with Dutch accounting principles, which have been restated to conform with US GAAP. No significant adjustments have arisen as a consequence of this restatement to conformity with US GAAP.

The Company's consolidated financial statements include the assets, liabilities and results of operations of its majority-owned subsidiaries. The ownership of the other interest holders is reflected as minority interests. All significant intercompany accounts and transactions have been eliminated in consolidation.

The initial combination of the SGS Microelettronica and Thomson Semiconducteurs civilian semiconductor businesses was accounted for as the creation of a joint venture. Accordingly, the assets and liabilities of the combined entities were recorded in the books of the joint venture at their carrying amounts at the date of combination.

2.2) Use of estimates

The presentation of financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported results of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

2.3) Income recognition

> **Sales:** Revenues on sales of semiconductor products are recognized upon shipment of the products. A portion of the Company's sales are made to distributors who participate in certain programs common to the semiconductor industry whereby the distributors are allowed to return merchandise under certain circumstances and may receive future price reductions. Provision is made at the time of sale for estimated product returns and price protection which may occur under programs the Company has with these customers.

> **Subsidies:** Government subsidies are recognized as related costs are incurred, commencing when the subsidies' contract is signed with the relevant government department or agency. Government subsidies for research and development are included in "other income and expenses". Government subsidies for indus-

trialization costs are offset against related expenses in "cost of sales". Government subsidies for capital expenditures are deducted from the cost of the related fixed assets.

2.4) Translation of foreign subsidiaries' financial statements

The United States dollar is the reporting currency for the Company because the Company does not have any operations in the Netherlands and the dollar is the currency of reference in terms of market pricing in the worldwide semiconductor industry. Furthermore, there is no currency in which the majority of transactions are denominated, and revenues from external sales in U.S. dollars exceed revenues in any other currency.

The functional currency used by each significant subsidiary throughout the group is the local currency. Assets and liabilities of these subsidiaries are translated at current rates of exchange at the balance sheet date. Income and expense items are translated at the average exchange rate for the period. The effects of translating the financial position and results of operation of local functional currency are included in shareholders' equity.

2.5) Foreign currency transactions

Assets, liabilities, revenue, expenses, gains or losses arising from foreign currency transactions are recorded in the functional currency of the recording entity at the exchange rate in effect at the date of the transaction. At each balance sheet date, recorded balances denominated in a currency other than the recording entity's functional currency are translated at the exchange rate prevailing at that date. The related exchange gains and losses are recorded in the income statement.

2.6) Intangible assets

Intangible assets include the cost of technologies and licenses purchased from third parties, amortized over a period ranging from five to eighteen years, and goodwill acquired in business combinations amortized over its estimated useful life, generally five to fifteen years.

2.7) Property, plant and equipment

Property, plant and equipment are stated at cost, net of government subsidies. Major renewals and improvements are capitalized; minor replacements, maintenance and repairs are charged to current operations. Depreciation is computed using the straight-line method over the following estimated useful lives:

Buildings	33 years
Leasehold improvements	10 years
Machinery and equipment	6 years
Computer and R&D equipment	3-6 years
Other	2-5 years

Assets subject to leasing agreements and classified as capital leases are included in property, plant and equipment and depreciated over the shorter of the estimated useful life or the lease term.

2.8) Investments

The equity accounting method is used when the Company has a 20% to 50% equity interest and the ability to exercise significant influence over the investee. Marketable debt and equity securities and other equity investments are classified as "available for sale" securities and stated at market value.

2.9) Inventories

Inventories are stated at the lower of cost or market (net realizable value). Cost is computed on a currently adjusted standard basis (which approximates actual cost on a current average basis).

2.10) Research and development

Research and development costs are charged to expense as incurred. Research and development costs include costs incurred by the Company as well as the Company's share of costs incurred by two French research and development interest groups. For some of its research and development programs, the Company receives grants from Governmental agencies; these grants are recognized in the income statement in "Other income and expenses".

2.11) Pension and termination indemnities

> **Pension:** Upon retirement, the Company's employees receive such benefits as are provided by pension plan arrangements; these plans conform with local regulations and practices of the countries in which the Company operates.

> **Termination indemnities:**

Italy Italian law provides for an indemnity to be paid to personnel upon termination of employment. The amount of indemnity is based upon the number of years of service. The undiscounted value of the vested obligation at the balance sheet date is recorded as a liability.

France In France, an indemnity is paid to personnel only upon retirement from the Company. The French entity recognizes the related cost and liability with the prior years' liability being amortized over the average remaining service period until retirement age.

2.12) Restructuring costs

Restructuring costs include incremental costs to be incurred as a result of the adoption by management of a formal plan to reorganize certain activities. Such costs may include severance payments, moving costs and fixed asset write-offs.

2.13) Income taxes

The provision for current taxes represents the income taxes expected to be payable for the current year. Deferred tax assets and liabilities are recorded for all temporary differences arising between the tax and book basis of assets and liabilities and for the benefits of tax credits and loss carryforwards. Those deferred tax assets and liabilities are measured using the enacted tax rates at which they are expected to be realized or paid. A valuation allowance is provided where necessary to reduce deferred tax assets to the amount expected to be "more likely than not" realized in the future. Tax rate changes are reflected in income in the period such changes are enacted.

2.14) Financial instruments

> **Interest rate swap agreements:** The Company enters into interest swap agreements with the purpose of reducing its interest rate exposure by changing the floating rates of certain loans into fixed rates. The differential to be paid or received is recognized in interest expense over the life of the agreements.

> **Foreign exchange forward contracts:** The Company enters into forward exchange contracts as a hedge against accounts payable and receivable in foreign currencies and against firm sale commitments (ranging from one to six months from the balance sheet date). Premiums or discounts on those contracts are recognized in the income statement over the life of the contract. Generally gains and losses associated with currency rate changes are recognized currently.

2.15) Stock options

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (FAS 123), "Accounting for Stock-Based Compensation", which establishes a fair value-based method of accounting for compensation costs related to stock option plans and other forms of stock based compensation plans as an alternative to the intrinsic value-based method of accounting as defined under Accounting Principles Board Opinion no. 25 (APB 25). The Company has decided not to elect the new method of accounting, and will provide pro forma disclosure as if the fair value-based method prescribed by FAS 123 had been applied in measuring compensation expense (note 11).

2.16) Advertising costs

Advertising costs are charged to operations when incurred. Advertising expenses for 1994, 1995 and 1996 were $6,644, $10,133 and $12,686, respectively.

2.17) Earnings per share

Earnings per share is calculated based upon the weighted average number of common shares and dilutive common stock equivalents using the treasury stock method. Dilutive common stock equivalents consist of stock options.

2.18) Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

3. CONSOLIDATED ENTITIES

The consolidated financial statements include the accounts of SGS-THOMSON Microelectronics N.V. and the following entities as of December 31, 1996:

Legal Seat		Name	Common Stock (Thousands)	Percentage Ownership (Direct or Indirect)
United Kingdom	London	SGS-THOMSON Microelectronics LTD	9,900 GBP	100
	London	Thomson Components LTD	1,150 GBP	100
	Bristol	SGS-THOMSON E.E.I.G.	0 GBP	100
Sweden	Stockholm	SGS-THOMSON Microelectronics A.B.	16,000 SEK	100
Germany	Munich	SGS-THOMSON Microelectronics GmbH	12,901 DEM	100
Switzerland	Geneva	SGS-THOMSON Microelectronics S.A.	500 CHF	100
Malta	Malta	SGS-THOMSON Microelectronics LTD	21,590 MTP	100
Spain	Madrid	SGS-THOMSON Microelectronics S.A.	55,000 ESP	100
France	Paris	SGS-THOMSON Microelectronics S.A.	2,289,764 FRF	100
	Paris	SGS-THOMSON Microelectronics S.N.C.	0 FRF	100
Italy	Milano	SGS-THOMSON Microelectronics S.R.L.	502,000,000 ITL	100
	Catania	CORIMME	14,000,000 ITL	100
Singapore	Singapore	SGS-THOMSON Microelectronics PTE LTD	179,997 SGD	100
	Singapore	SGS-THOMSON Microelectronics ASIA PACIFIC PTE LTD	13,982 SGD	100
Malaysia	Muar	SGS-THOMSON Microelectronics SDN BHD	196,805 MYR	100
	Muar	SGS-THOMSON (Malaysia) SDN BHD	0.002 MYR	100
Japan	Tokyo	SGS-THOMSON Microelectronics KK	68,000 JPY	100
Hong Kong	Hong Kong	SGS-THOMSON Microelectronics LTD	780 HKD	100
Australia	Sydney	SGS-THOMSON Microelectronics PTY LTD	185 AUD	100
United States	Dallas	SGS-THOMSON Microelectronics Inc.	22,000 USD	100
	Rancho Ber.	SGS-THOMSON Microelectronics (RB), Inc.	1 USD	100
	Dallas	SGS-THOMSON Microelectronics Leasing Co Inc.	1 USD	100
Brazil	Sao Paulo	SGS-THOMSON Microelectronics Ltda	14,314 BRL	100
Morocco	Casablanca	SGS-THOMSON Microelectronics S.A.	66,000 MAD	100
	Casablanca	Electronic Holding S.A.	3,110 MAD	100
China	Shenzhen	Shenzhen STS Microelectronics Co LTD	252,748 CNY	60
India	New Delhi	SGS-THOMSON Microelectronics PTE LTD	62,000 INR	100