STMICROELECTRONICS NV
Form 6-K
March 28, 2006

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 6-K
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 or 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934
Report on Form 6-K dated March 28, 2006

STMicroelectronics N.V.
(Name of Registrant)
39, Chemin du Champ-des-Filles
1228 Plan-les-Ouates, Geneva, Switzerland
(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.
Form 20-F þ Form 40-F o
Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):
Yes o No þ
Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.
Yes o No þ
If Yes is marked, indicate below the file number assigned to the registrant in connection with
Rule 12g3-2(b): 82- __________
Enclosure: Shareholder materials for STMicroelectronics Annual General Meeting of Shareholders (AGM) of April 27, 2006, including: (i) AGM Agenda; (ii) Statutory Annual Report of STMicroelectronics N.V. (Dutch holding company) for the year ended December 31, 2005 (IFRS); (iii) Proposed AGM Resolutions; (iv) Proposed Supervisory Board Member Data Forms and (v) Proxy Forms and Instruction Cards.

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Annual General Meeting of Shareholders
2006
Agenda

Annual General Meeting of Shareholders of STMicroelectronics N.V., established in Amsterdam, the Netherlands, to be held on April 27, 2006 at 10.30 a.m. at the Pulitzer Hotel, Amsterdam, the Netherlands.

1. Call to order and opening

2. Report of the Managing Board on the 2005 financial year and discussion thereof

3. Report of the Supervisory Board on the 2005 financial year and discussion thereof

4.
   a. Discussion on and adoption of the annual accounts for the 2005 financial year

   b. Adoption of a dividend of US$0.12 per common share

   c. Discharge of the sole member of our Managing Board

   d. Discharge of the members of our Supervisory Board.

5. Appointment of three members of our Supervisory Board

6. Adoption of the compensation of the members of our Supervisory Board

7. Approval of the stock-based portion of the compensation of our President and CEO

8. Approval of the main terms for the grant of Stock-Based Compensation for selected employees and delegation to our Supervisory Board of the authority to approve all other terms of such grant

9. Delegation to our Supervisory Board for five years of the authority to issue new shares, to grant rights to subscribe for new shares and to limit and/or exclude existing shareholders pre-emptive rights

10. Question time

11. Close

Copies of the annual accounts, the report of the Supervisory Board, the report of the Managing Board, the personal data of the proposed members of the Supervisory Board as referred to in Section 2:142 subsection 3 of the Dutch Civil Code and other information included pursuant to law and the proposed resolutions (including shareholders information) will be deposited for inspection by the shareholders and other persons entitled to attend the meeting at the offices of Netherlands Management Company B.V. (Locatellikade 1, 1076 AZ Amsterdam, the Netherlands), at the offices of Crédit Agricole Investor Services Corporate Trust S.N.C. (14, Rouget de Lisle, 92862 Issy-les-Moulineaux, Cedex 09), at the offices of the Company in New York (Corporate Information Office, 780 Third Avenue, 9th Floor, New York, New York 10017, United States of America) and at the offices of Banca Intesa S.p.A. (Centro Amministrativo Elettronico, Via Langhirano 1, CAP 43100 Parma, Italy) as of March 28, 2006 up to and including the date of the meeting. The documents are also available on the Company s internet site www.st.com and in print at the Company s registered offices.

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THIS STATUTORY ANNUAL REPORT HAS BEEN APPROVED AND DULY SIGNED BY:

THE MANAGING BOARD

Carlo Bozotti

THE SUPERVISORY BOARD

Gérald Arbola
Bruno Steve
Tom de Waard
Matteo del Fante
Douglas Dunn
Francis Gavois
Didier Lombard
Antonino Turicchi
Robert M. White

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THE MANAGING BOARD IN 2005

Pasquale Pistorio (1936)

Former President and Chief Executive Officer. Served as the Sole Member of the Managing Board until the 2005 annual general meeting of shareholders held on March 18, 2005

Italian nationality

Carlo Bozotti (1952)

President and Chief Executive Officer, serving as the Sole Member of the Managing Board upon his appointment at the 2005 annual general meeting of shareholders held on March 18, 2005

Italian nationality

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THE SUPERVISORY BOARD IN 2005

Gérald Arbola (1948) Chairman
First appointed 2004
Chief Financial Officer and member of the Executive Board of Areva
Current term until 2008
French nationality

Bruno Steve (1941) Vice Chairman
First appointed 1989
President of the Board of Statutory Auditors of Alitalia S.p.A.
Current term until 2008
Italian nationality

Matteo del Fante (1966)
First appointed 2005
Chief Financial Officer of CDP in Rome
Current term until 2008
Italian nationality

Tom de Waard (1946)
First appointed 1998
Member of the Management Committee at Clifford Chance
Current term until 2008
Dutch nationality

Douglas Dunn (1944)
First appointed 2001
Former President and Chief Executive Officer of ASML Holding N.V.
Current term expires at the 2006 AGM
British nationality

Riccardo Gallo (1943)
First appointed in 1997
Associate professor of Industrial Economics
Mandate expired at the 2005 AGM
Italian nationality

Francis Gavois (1935)
First appointed 1998
Former Chairman of the Board of Directors and Chief Executive Officer of Banque Française du Commerce Extérieur (BFCE)
Current term expires at the 2006 AGM
French nationality

Didier Lombard (1941)
First appointed 2004
Chairman and Chief Executive Officer of France Telecom
Current term until 2008
French nationality

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Alessandro Ovi (1943)
First appointed 1994
Special advisor to the former President of the European Union
Mandate expired at the 2005 AGM
Italian nationality
Antonino Turicchi (1965)
First appointed 2005
Managing Director of CDP in Rome
Current term until 2008
Italian nationality
Robert M. White (1938)
First appointed 1996
University Professor Emeritus Carnegie Mellon University
Current term expires at the 2006 AGM
American nationality

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REPORT OF THE SUPERVISORY BOARD

Annual Results under International Financial Reporting Standards (IFRS) in compliance with Dutch Statutory requirements

For the first time, ST is submitting for approval by its shareholders accounts prepared using IFRS accounting principles instead of accounting principles generally accepted in The Netherlands (Dutch GAAP) which have been drawn up by management, examined and audited by PricewaterhouseCoopers Accountants N.V. and approved by the Supervisory Board. The Company s results as reported using IFRS accounting standards differ from those reported pursuant to accounting principles generally accepted in the United States (U.S. GAAP) and contained in our annual report as filed with the Securities and Exchange Commission (SEC) on March 3, 2006. Although IFRS constitutes the Company s legal reporting standard effective 2006, ST wants to inform its shareholders and other stakeholders that it intends, with the full support of its Supervisory Board, to continue in its quarterly communications to investors and shareholders to use U.S. GAAP as its primary reporting standard to ensure continuity and consistency in its financial reporting.

Supervisory Board and ST Corporate Governance

The Supervisory Board advises the Managing Board and is responsible for supervising the policies pursued by the Managing Board as well as the general course of ST s affairs and business.

In the area of corporate governance, the Supervisory Board devoted significant attention, in 2005, to monitoring the corporate governance requirements for the Company in the various jurisdictions in which ST is listed and incorporated, particularly those pursuant to the Dutch Corporate Governance Code (the Code) and the evolving rules and corporate governance standards of the SEC and of the New York Stock Exchange (NYSE). Notably, the Supervisory Board reviewed the Company s Corporate Governance Charter and Supervisory Board Charter, which also described the independence requirements for the Supervisory Board members. The updated charters were last approved by the Supervisory Board in July 2005 and are posted on ST s website under Corporate Governance.

In fulfilling their duties under Dutch law, Supervisory Board members serve the best interests of all of ST s stakeholders and of ST s business. The Supervisory Board is carefully selected based upon the combined experience and expertise of its members. In addition, as required by Dutch law, all of the members of the Supervisory Board, however originally selected, act independently in their supervision of ST s management.

The above mentioned independence criteria differ to a certain extent from those set forth in best practice provision III.2.2.

The Supervisory Board also adopted procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters. These procedures are incorporated in the Company s Business Conduct and Ethics policy, which is also posted on the Company s website under Corporate Governance .

Proposed Supervisory Board Appointments

Pursuant to extensive research conducted by the Nominating and Corporate Governance Committee with the support of a top executive research specialist, in March 2006, the

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Nominating and Corporate Governance Committee submitted its report to the Supervisory Board, identifying candidates for the three Supervisory Board positions up for renewal at the 2006 Annual General Meeting of Shareholders (2006 AGM). In view of the recommendations made by the Nominating and Corporate Governance Committee, the Supervisory Board proposes to the shareholders: the appointment for a three-year term until the 2009 Annual General Meeting of Shareholders (2009 AGM) of Mr. Didier Lamouche as a new member of the Supervisory Board in replacement of Mr. Francis Gavois whose mandate expires at the forthcoming Annual General Meeting of Shareholders (AGM), the reappointment of Mr. Doug Dunn for a new three-year term until the 2009 AGM, as well as the reappointment of Mr. Robert White for an additional one-year term until the AGM in 2007. Mr. Didier Lamouche has been selected for his international experience in management functions for technology companies. The proposal to reappoint Mr. Doug Dunn and Mr. Robert White are also based on the international experience of such candidates.

The Supervisory Board wishes to warmly thank Mr. Francis Gavois for his significant contributions to the works of the Supervisory Board, and in particular its Audit Committee.

The Supervisory Board notes that pursuant to the proposed appointments the mandates of the Supervisory Board members will be staggered with one mandate expiring at the 2007 AGM, six mandates expiring at the 2008 AGM and two mandates expiring at the 2009 AGM.

Proposed 2006 Cash Dividend and Retained Earnings and Dividend Policy

Upon the proposal of the Managing Board, the Supervisory Board decided to recommend to the 2006 AGM a cash dividend of $0.12 per share, equal to last year s cash dividend distribution.

This recommendation is consistent with the Company s dividend policy as communicated and discussed at the 2005 Annual General Meeting of Shareholders (2005 AGM) whereby:

a) The Company seeks to use its available cash in order to develop and enhance its position in the very capital-intensive semiconductor market while at the same time managing its cash resources to reward its shareholders for their investment and trust in the Company;

b) Based on its annual results, projected capital requirements as well as business conditions and prospects, the Managing Board proposes each year to the Supervisory Board the allocation of its earnings involving whenever deemed possible and desirable in line with the Company s objectives and financial situation, the distribution of a cash dividend; and

c) The Supervisory Board, upon the proposal of the Managing Board, decides each year, in accordance with this policy, which portion of the profits shall be retained in reserves to fund future growth or for other purposes and makes a proposal to the shareholders concerning the amount, if any, of the annual cash dividend.

Supervisory Board Activities in 2005

The Supervisory Board is comprised of the following nine members: Messrs. Arbola (Chairman), Steve (Vice Chairman), del Fante, de Waard, Dunn, Gavois, Lombard, Turicchi and White since our last AGM. During 2005, the Supervisory Board met seven times so as to

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closely monitor ST s operations, strategy and evolution. Attendance at full Supervisory Board Meetings and Committee Meetings in 2005 was as follows:

Number of meetings attended in 2005[1]	Full Board	Compensation Committee	Strategic Committee	Audit Committee	Nominating and Corporate Governance Committee	Financing Committee
Bruno Steve	7	5	4		4	
Gérald Arbola	7	5	4		4	
Tom de Waard	7	5		11	4	1
Douglas Dunn	7			9		
Francis Gavois[3]	7			11		1
Antonino Turicchi[2]	5	3	3		2	
Didier Lombard	7	3	4		1	
Matteo del Fante[2][3]	5			7		1
Robert M. White	7		4	11		
Riccardo Gallo[2]	2			4		
Alessandro Ovi[2]	2		1			

(1) Includes meetings attended by way of conference call.

(2) Messrs. Riccardo Gallo and Alessandro Ovi, who were Supervisory Board Members throughout fiscal year 2004, were replaced by Messrs. Antonino Turicchi and Matteo del Fante at the Annual General Meeting of Shareholders on March 18, 2005.

(3) Appointed as non-voting observer to Audit Committee.

The remuneration of the Supervisory Board members is described in Note 17 of the Company Financial Statements 2005.

Biographies of the Supervisory Board members are available in Annex 1 of this Supervisory Board report, which will posted on ST s website.

In 2005, the Supervisory Board s activities comprised, *inter alia*:

Approval of the Company s consolidated accounts, profit and loss accounts, balance sheet and cash-flow statement in U.S. GAAP, as published quarterly by the management, including review and approval of the associated press release.

Approval prior to the 2005 AGM, of the proposal to appoint Mr. Carlo Bozotti as Sole Member of the Managing Board, President and Chief Executive Officer (CEO) replacing Mr. Pasquale Pistorio, as well as the approval of the proposal made by Mr. Bozotti to appoint Alain Dutheil as Chief Operating Officer (COO), reporting to the CEO. The Supervisory Board was also informed of other changes made in 2005 to the executive officers and management organization by Mr. Bozotti.

Approval prior to the 2005 AGM, of the proposal to appoint members to the Supervisory Board, as well as the appointment of members for the Committees of the Supervisory Board.

Approval prior to the 2005 AGM, of the proposal to appoint PricewaterhouseCoopers Accountants N.V. as the Company s auditors for a three-year term.

Nomination of Mr. Pasquale Pistorio as Honorary Chairman of the Company.

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Approval of the Company s related party transactions. In particular, the Supervisory Board determined that the Equant contract, the development and license agreement with Quadrics Limited and transactions with Thomson are concluded in the ordinary course of business at normal conditions and are in ST s best interests.

Approval of the Company s plans to refinance its existing 2013 Convertible Bonds, which provide holders with the right to require ST to redeem the bonds at their accreted value on August 5, 2006. In this context, the Supervisory Board decided to create an Ad Hoc Committee (the Financing Committee), composed of Messrs. del Fante, Gavois and de Waard with the mandate and related authority to take any decision as required to be taken by the Supervisory Board for the issuance of a new convertible bond offering, as well as the Company s first senior bond offering.

Adoption of the terms and conditions of the Stock-Based Compensation Plan 2005-2007 for Supervisory Board members and professionals, consistent with the approval given by the 2005 AGM.

Approval of amendments to the Company s existing 2001-2005 Employee Stock Option Plan, consistent with the approval given by the 2005 AGM.

Approval of the decisions and terms and conditions of grant under the employee stock-based compensation plan. In particular, the Supervisory Board sought to ensure that the conditions linked to the Company s performance, which are required to be met for the vesting of the 4,100,000 stock awards granted in 2005 to employees of the Company, including the CEO pursuant to the amended 2001-2005 Stock-Based Compensation Plan, are related to the creation of long-term value for our shareholders.

Approval of the compensation policy for Mr. Carlo Bozotti as CEO, outside the presence of Mr. Bozotti. Review of the CEO performance in 2005 with respect to the defined performance criteria, outside the presence of Mr. Bozotti.

Review of the Company s corporate governance procedures, including conflicts of interest, trading in the Company s shares, confidentiality obligations for Supervisory Board members, the Supervisory Board Charter and the Company s Corporate Governance Charter.

Review of the Company s long-term strategy and business prospects, and approval of the General guidelines as well as of the Company s 2006 Budget.

Review of the plans and progress of the Company s Research and Development (R&D) effectiveness program and Key Projects.

Approval of the proposals by the Nominating and Corporate Governance Committee regarding nominations of Supervisory Board members.

The Supervisory Board s committees were also very active in 2005.

Compensation Committee

The Compensation Committee, whose current members are Messrs. Arbola (Chairman), Steve, Turicchi, Lombard and de Waard, met four times in 2005, including one meeting outside the presence of management and the President and CEO.

The Compensation Committee specifically reviewed and approved the Company s Managing Board compensation policy and the compensation package of the President and CEO for the year 2005, and proposed to the Supervisory Board the total compensation package for the Sole Member of the Managing Board, President and CEO of the Company as well as the employment agreements to cover the respective positions, Sole Member of the Managing Board on the one hand, President and CEO on the other hand, which were approved by the Supervisory Board. The 2005 AGM approved the compensation policy of the President, CEO and Sole Member of the Managing Board.

The remuneration for the function of President and CEO for the 2005 financial year, which was proposed by the Compensation Committee and approved by the Supervisory Board, consisted of a base salary of approximately $700,000 and a cash bonus computed following an evaluation by the Compensation Committee of the CEO s performance vis-à-vis predetermined performance targets related to: (i) the Company s R&D programs; (ii) the Company s sales; (iii) the Company s stock performance; (iv) the Company s financial performance; and (v) the build up of the new organization. For 2005, on March 14, 2006, the Supervisory Board upon the recommendation of its Compensation Committee fixed the CEO s bonus at approximately 95% of the CEO s base salary out of a possible maximum bonus of 150%.

In 2005, the President and CEO was also awarded, by the Supervisory Board upon the recommendation of its Compensation Committee, up to 100,000 non-vested shares subject to the achievement of predetermined performance criteria objectives fixed by the Supervisory Board. Such stock-based compensation was approved by last years AGM. None of the restricted shares have vested, as vesting is linked to the achievement of certain performance objectives, which will only be known at the end of the first quarter of 2006. The President and CEO further benefited from a pension plan that was granted in line with the pension benefits granted to all employees of ST s Swiss branch. The Supervisory Board, in 2005, also approved the establishment of a complementary pension plan for the CEO and other top executive management, which is not yet in effect.

On March 14, 2006, the Supervisory Board, upon the recommendation of its Compensation Committee, decided to maintain the base salary of the President and CEO for 2006 at $700,000 and to fix a maximum cash bonus of up to 150% of his base salary based on predetermined performance targets for 2006 designed to generate value creation and related to: (i) the Company s new products; (ii) the Company s market share; (iii) the Company s stock performance and (iv) the Company s financial performance.

In addition, the Compensation Committee recommended the grant of up to a maximum number of 100,000 shares in stock-based compensation to Mr. Bozotti for services to be rendered in 2006, which the Company is proposing for approval by its shareholders at its forthcoming annual general meeting, and which is further subject to the Company meeting specific sales and financial performance objectives to be defined by the Supervisory Board.

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The Compensation Committee also reviewed and approved a proposal by the Managing Board to amend the existing 2001 Stock Option Plan for senior executives and key employees of the Company to provide for the grant of non-vested shares instead of stock options. The Compensation Committee reviewed the status of past grants, which were no longer functioning as a retention tool, and approved amendments with the objective of better incentivizing our senior executives and key employees through the grant of stock awards as approved by our 2005 AGM. The Compensation Committee reviewed and recommended the criteria relating to our share price, sales and financial performances as well as the continued service requirements to be met for the granted shares to vest in favor of their designated beneficiaries. The Compensation Committee also approved the list of proposed beneficiaries and the amount of granted shares pursuant to the proposal of the Company s management and upon the delegation from the Company s Supervisory Board. Furthermore, the Compensation Committee with the approval of the Supervisory Board authorized the Sole Member of the Managing Board to grant up to 159,935 non-vested share awards plus the shares previously attributed to employees who subsequently left the Company, so that the total number of shares granted to executives and key employees under the Plan in addition to the 100,000 shares which may be received by the Company s President and CEO may reach 4.1 million shares in accordance with the authorizations granted by the Company s 2005 AGM.

The Compensation Committee also reviewed and submitted to the Supervisory Board for the relevant approval, the proposal concerning the establishment of a stock-based compensation grant to members and professionals of the Supervisory Board for a three-year period in accordance with the authorizations granted by the Company s 2005 AGM.

The Company has not granted any loans to, nor has it granted any guarantees in favor of any of the members of the Supervisory Board and the Sole Member of the Managing Board.

Strategic Committee

The Strategic Committee, whose current members are Messrs. Arbola (Chairman), Steve, Turicchi, Lombard and White, met four times in 2005, in the presence of the CEO, the COO, the Director of Strategy and the Chief Financial Officer (CFO). Among its main activities, the Strategic Committee reviewed the Company s long-term plans and prospects and various possible scenarios and opportunities to meet the challenges of the semiconductor market.

The Strategic Committee also was consulted on various other matters.

Audit Committee

The current members of the Audit Committee are Messrs. de Waard (Chairman), Dunn and White and the current non-voting observers are Messrs. del Fante and Gavois. The Audit Committee met 11 times during 2005. At many of these meetings, the Audit Committee received presentations on current financial and accounting issues and had the opportunity to interview the CEO, CFO, General Counsel and external and internal auditors. On several occasions, the Audit Committee met with outside U.S. legal counsel, who explained and analyzed actions required by the new NYSE s final and amended corporate governance rules and the Sarbanes-Oxley Act. In addition, the Audit Committee regularly discussed the progress of implementation of internal controls over financial reporting and reviewed management s conclusions as to the effectiveness of internal controls.

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At the end of each quarter, prior to each Supervisory Board meeting to approve the results and quarterly earnings press release, the Audit Committee reviewed the interim financial information and the proposed press release and had the opportunity to raise questions to management and the independent registered public accounting firm. In addition, the Audit Committee reviewed the quarterly Operating and Financial Review and Prospects and the interim Consolidated Financial Statements (and notes thereto) before they were filed with the SEC and voluntarily certified by the CEO and the CFO (pursuant to sections 302 and 906 of the Sarbanes-Oxley Act).

The Audit Committee also reviewed the annual Consolidated Financial Statements under U.S. GAAP for the year ended December 31, 2005 and the associated press release published on January 24, 2006 as well as the Company s 2005 Annual Report as filed with the SEC on March 3, 2006. Additionally, the Audit Committee reviewed the external auditors statement of independence with them. The Audit Committee also approved the compensation of the external auditors and approved the scope of their audit, audit-related and non-audit-related services for 2006. Furthermore, the Audit Committee held separate meetings with the external auditors and discussed with them ST s critical accounting policies, outside the presence of the Company s management. The Audit Committee also reviewed and approved the internal audit plan for 2005 as well as the scope, planning and costs of external audit activities. Furthermore, the Audit Committee monitored ST s compliance with the European Directive that requires the Company to prepare a set of accounts pursuant to IFRS in advance of the 2006 AGM. In this respect, the Audit Committee has approved the decision to continue to report the Consolidated Financial Statements under U.S. GAAP, while complying with the reporting obligations under IFRS by preparing a set of 2005 statutory accounts. Furthermore, the Audit Committee has noted that while the Company s accounting systems are in place to prepare a full set of accounts pursuant to IFRS for financial year 2005, the Company did not have systems and controls in place to enable the accurate accumulation of costs to be capitalized in respect of its development expenses prior to 2005. Finally, the Audit Committee has, with the Company s management, analyzed the various other constraints related to the preparation for the first time of consolidated accounts with specific footnotes and account details, using a new set of reporting standards, IFRS, where a significant number of new standards are being released and interpretations are evolving, and has recommended to the Supervisory Board the approval of the Company s Statutory Annual Report for 2005 in IFRS as presented to the shareholders at the AGM of April 27, 2006.

In 2005, in compliance with NYSE requirements, the Audit Committee established procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, and the confidential anonymous submission by employees of the Company regarding questionable accounting or auditing matters. These procedures were approved by the Supervisory Board and implemented under the responsibility of the Managing Board.

The Audit Committee reviewed its charter with the assistance of outside U.S. counsel, completed a self-evaluation and reported regularly to the Supervisory Board. The Audit Committee Charter is posted on the ST website under Corporate Governance .

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Nominating and Corporate Governance Committee

On October 25, 2005, the Supervisory Board appointed Mr. Tom de Waard as President of the Nominating and Corporate Governance Committee and Messrs. Arbola, Steve, Turicchi and Lombard as members. In 2005, the Nominating and Corporate Governance Committee met two times before the 2005 AGM and two times after the 2005 AGM.

The Nominating and Corporate Governance Committee reviewed the structure and composition of the Supervisory Board in view of the pending expiration of the terms of Messrs. Dunn, Gavois and White. The Nominating and Corporate Governance Committee began in the fall of 2005 to evaluate the profiles of candidates and decided to appoint a top executive research specialist to assist it in this mission, and since the beginning of 2006 has examined proposals to fill the three positions up for renewal at the 2006 AGM.

The Nominating and Corporate Governance Committee advised the Supervisory Board on the recommendations to be submitted for shareholder approval at the 2006 AGM.

Financing Committee

A Financing Committee whose members were Messrs. del Fante, Gavois and de Waard was created by the Supervisory Board with the mandate to take any decision as required to be taken by the Supervisory Board for the implementation of the Company s project for refinancing its 2013 Convertible Bonds. The Financing Committee met once in 2005 and also held conference calls with the CFO, to review the market conditions for a new convertible bond offering and other financing options, the process and criteria for selecting the banks, the timing for the launch of any offering and the terms for the invitation to underwrite. In 2006, the Financing Committee, duly delegated by the Supervisory Board, approved the final conditions regarding the amount of the new convertible bond offering and resolved upon the issuance of the number of shares to serve the relevant conversion and approved the Company s first senior bond offering, issued by a new finance subsidiary and guaranteed by the Company.

Conclusion

Finally, the Supervisory Board, in conjunction with the Managing Board, prepared the agenda for the AGM. The Supervisory Board also voted on March 23, 2006 to adopt this report and recommend for adoption of the proposed resolutions. The agenda, proposed resolutions and other information regarding the upcoming AGM are available on ST s website and in print to any shareholder upon request.

Approved by the Supervisory Board Members on March 23, 2006

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ANNEX 1

Current members of ST s Supervisory Board

Gérald Arbola was appointed to our Supervisory Board at the 2004 annual shareholders meeting and was reelected at the 2005 annual shareholders meeting. Mr. Arbola was appointed the Chairman of our Supervisory Board on March 18, 2005. Mr. Arbola previously served as Vice Chairman of our Supervisory Board from April 23, 2004 until March 18, 2005. Mr. Arbola is also Chairman of our Supervisory Board s Compensation Committee and Strategic Committee, and serves on its Nominating and Corporate Governance Committee. Mr. Arbola has served as Chief Financial Officer and member of the Executive Board of Areva since July 3, 2001. Mr. Arbola joined the Cogema group in 1982 as Director of Planning and Strategy for SGN, then served as Chief Financial Officer at SGN from 1985 to 1989, becoming Executive Vice President of SGN in 1988 and Chief Financial Officer of Cogema in 1992. He was appointed as a member of the executive committee in 1999, and also served as Chairman of the Board of SGN in 1997 and 1998. Mr. Arbola is currently a member of the boards of directors of Cogema, Framatome ANP, Areva T&D Holdings and Chairman of Areva Finance Gestion S.A. and Cogerap. Mr. Arbola is a graduate of the Institut d Etudes Politiques de Paris and holds an advanced degree in economics. Mr. Arbola is the Chairman of the Supervisory Board of ST Holding and a Chairman of the Board of Directors of FT1CI. Mr. Arbola is 57 years old.

Bruno Steve has been a member of our Supervisory Board since 1989 and was appointed Vice Chairman of our Supervisory Board on March 18, 2005, and previously served as Chairman of our Supervisory Board from March 27, 2002 through March 18, 2005, from July 1990 through March 1993, and from June 1996 until May 1999. He also served as Vice Chairman of the Supervisory Board from 1989 to July 1990 and from May 1999 through March 2002. Mr. Steve serves on our Supervisory Board s Compensation Committee as well as on its Nominating and Corporate Governance and Strategic Committees. He was with Istituto per la Ricostruzione Industriale-IRI S.p.A. (IRI), a former shareholder of Finmeccanica, Finmeccanica and other affiliates of IRI in various senior positions for over 17 years. He is currently President of the statutory board of Selex Sensor and Airborne Systems. Mr. Steve served as President of the board of statutory auditors of Alitalia S.p.a. until June 2005. Until December 1999, he served as Chairman of MEI. He served as the Chief Operating Officer of Finmeccanica from 1988 to July 1997 and Chief Executive Officer from May 1995 to July 1997. He was Senior Vice President of Planning, Finance and Control and IRI from 1984 to 1988. Prior to 1984, Mr. Steve served in several key executive positions at Telecom Italia. He is also a professor at LUISS Guido Carli University in Rome. Mr. Steve was Vice Chairman from May 1999 to March 2002, Chairman from March 2002 to May 2003 and member until his resignation on April 21, 2004 of the Supervisory Board of ST Holding, our largest shareholder. Mr. Steve is 64 years old.

Doug Dunn has been a member of our Supervisory Board since 2001. He is a member of its Audit Committee since such date. He was formerly President and Chief Executive Officer of ASML Holding N.V. (ASML), an equipment supplier in the semiconductor industry, a position from which he retired effective October 1, 2004. Mr. Dunn currently serves as a non-executive director on the Board of Directors of ARM Holdings plc, a UK company, LG.Philips LCD, a Korean company, OMI, an Irish company, SOITEC, a French company, and on the board of TomTom NV. He is also a member of the audit committees of ARM Holdings plc, SOITEC and TomTom N.V. Mr. Dunn was a member of the Managing Board of Royal Philips Electronics in 1998. From 1996 to 1998 he was Chairman and Chief

Executive Officer of Philips Consumer Electronics and from 1993 to 1996 Chairman and Chief Executive Officer of Philips Semiconductors. From 1980 to 1993 he held various positions at Plessey Semiconductors. Mr. Dunn is 61 years old.

Tom de Waard has been a member of our Supervisory Board since 1998. Mr. de Waard was appointed Chairman of the Audit Committee by the Supervisory Board in 1999 and Chairman of the Nominating and Corporate Governance Committee in 2004 and 2005, respectively. He also serves on our Supervisory Board s Compensation Committee. Mr. de Waard has been a partner of Clifford Chance, a leading international law firm, since March 2000 and was the Managing Partner of Clifford Chance Amsterdam office from May 1, 2002 until May 1, 2005. As of January 1, 2005, he was elected to the Management Committee of Clifford Chance, where he represents Continental Europe. Prior to joining Clifford Chance, he was a partner at Stibbe, where he held several positions since 1971 and gained extensive experience working with major international companies, particularly with respect to corporate finance. He is a member of the Amsterdam bar and was President of the Netherlands Bar Association from 1993 through 1995. He received his law degree from Leiden University in 1971. Mr. de Waard is a member of the Supervisory Board of BESI N.V. and of its audit and nominating committees. He is also chairman of BESI s compensation committee. Mr. de Waard is a member of the board of the foundation Stichting Sport en Zaken . Mr. de Waard is 59 years old.

Matteo del Fante was appointed to our Supervisory Board at our 2005 annual shareholders meeting. Mr. del Fante is also a non-voting observer on its Audit Committee. Mr. del Fante has served as the Chief Financial Officer of CDP in Rome since the end of 2003. Prior to joining CDP, Mr. del Fante held several positions at JPMorgan Chase in London, England, where he became Managing Director in 1999. During his 13 years with JPMorgan Chase, Mr. del Fante worked with large European clients on strategic and financial operations. Mr. del Fante obtained his degree in Economics and Finance from Università Bocconi in Milan in 1992, and followed graduate specialization courses at New York University s Stern Business School. Mr. del Fante is the Vice Chairman of the Supervisory Board of ST Holding, our largest shareholder. Mr. del Fante is 39 years old.

Francis Gavois has been a member of our Supervisory Board since 1998. Mr. Gavois is currently a non-voting observer on the Audit Committee of our Supervisory Board after previously having served as a voting member through March 18, 2005. Mr. Gavois is a member of the Boards of Directors and of the audit committee of Plastic Omnium and the Consortium de Réalisation (CDR). He also served as the Chairman of the Supervisory Board of ODDO et Cie until May 2003. From 1984 to 1997, Mr. Gavois held several positions, including Chairman of the Board of Directors and Chief Executive Officer of Banque Française du Commerce Extérieur (BFCE). Prior to that time Mr. Gavois held positions in the French government. He is Inspecteur des Finances and a graduate of the Institut d Etudes Politiques de Paris and the Ecole Nationale d Administration. Mr. Gavois is also a member of the Supervisory Boards of ST Holding and FT1CI. Mr. Gavois is 70 years old.

Mr. Didier Lamouche is a graduate of *Ecole Centrale de Lyon* and holds a PhD in semi-conductor technology. He has 25 years experience in the semiconductor industry. Mr. Lamouche started his career in 1984 in the R&D department of Philips before joining IBM Microelectronics where he held several positions in France and the United States. In 1995, he became Director of Operations of Motorola s Advanced Power IC unit in Toulouse (France). Three years later, he joined IBM to lead the turnaround of the semiconductor site in Corbeil. Once restructuring and redeployment were achieved, he created and managed as CEO Altis Semiconductor, a joint venture between IBM and Infineon. From 2003 to

December 2004, Mr. Lamouche was Vice-President for IBM, based in the United States. Since December 2004, Mr. Lamouche has been the Chairman and CEO of Groupe Bull. He is also a member of the Board of Directors of CAMEC and SOITEC.

Didier Lombard was first appointed to the Supervisory Board at the 2004 annual shareholders meeting and was reelected at the 2005 Annual Shareholders Meeting. He serves on the Compensation and Strategic Committees of our Supervisory Board. Mr. Lombard was appointed Chairman and Chief Executive Officer of France Telecom in March 2005. Mr. Lombard began his career in the Research and Development division of France Telecom in 1967. From 1989 to 1990, he served as scientific and technological director at the Ministry of Research and Technology. From 1991 to 1998, he served as General Director for industrial strategies at the French Ministry of Economy, Finances and Industry, and from 1999 to 2003 he served as Ambassador at large for foreign investments in France and as President of the French Agency for International Investments. From 2003 through February 2005, he served as France Telecom s Senior Executive Vice President in charge of technologies, strategic partnerships and new usages and as a member of France Telecom s Executive Committee. Mr. Lombard also spent several years as Ambassador in charge of foreign investment in France. Mr. Lombard is also Chairman of the Board of Directors of Orange and a member of the Board of Directors of Thomson, one of our important customers, and Wanadoo, as well as a member of the Supervisory Board of ST Holding (our largest shareholder) and Radiall. Mr. Lombard is a graduate of the Ecole Polytechnique and the Ecole Nationale Supérieure des Télécommunications. Mr. Lombard is 64 years old.

Antonino Turicchi was appointed as a member of our Supervisory Board at our 2005 annual shareholders meeting. He serves on its Compensation and Strategic Committees. Mr. Turicchi earned a degree cum laude in Economics and Business from the University of Rome and, after receiving a scholarship from Istituto San Paolo di Torino, he attended the masters program in Economics at the University of Turin in 1991 and 1992. In 1993, he was awarded a grant from the European Social Fund to attend the masters program in International Finance and Foreign Trade. Mr. Turicchi has been Managing Director of CDP in Rome since June 2002. From 1994, Mr. Turicchi held positions with the Italian Ministry of the Treasury (now known as the Ministry of the Economy and Finance). In 1999, he was promoted to director responsible for conducting securitization operations and managing financial operations as part of the treasury s debt management functions. Between 1999 and June 2002, Mr. Turicchi was also a member of the board of Mediocredito del Friuli; from 1998 until 2000, he served on the board of Mediocredito di Roma; and from 2000 until 2003, he served on the board of EUR S.p.A. Mr. Turicchi is 40 years old.

Robert M. White has been a member of our Supervisory Board since 1996. He serves on its Strategic and Audit Committees. Mr. White is a University Professor Emeritus at Carnegie Mellon University and serves as a member of several corporate boards, including that of Silicon Graphics, Inc., as well as on its audit committee and nominating and corporate governance committee. Mr. White is a member of the U.S. National Academy of Engineering and the recipient of the American Physical Society s Pake Prize for research and technology management in 2004. From 1990 to 1993, Mr. White served as Under Secretary of Commerce for Technology in the United States government. Prior to 1990, Mr. White served in several key executive positions, including Principal Scientist for Xerox Corporation and Vice President and Chief Technology Officer for Control Data Corporation. He received a doctoral degree in Physics from Stanford University and graduated with a degree in Physics from the Massachusetts Institute of Technology. Mr. White is 67 years old.

REPORT OF THE MANAGING BOARD

2005 has been a year devoted to strengthening and reshaping ST into a stronger and more competitive industry leader. We have undertaken a number of important initiatives and have made good progress in implementing all of them.

The first important initiative was research and development (R&D) effectiveness, with the primary objective of improving time to market both for technologies and for products. We are addressing this through a comprehensive plan involving a coordinated maneuver that has implied organizational changes, the redeployment of important resources and a significantly higher focus on the selection of programs and discipline on their execution.

The second main set of initiatives were focused on Sales Expansion. Here again, just as for R&D, our actions were deployed on several fronts as we target major new accounts, while at the same time reorganizing to sharpen our efforts and improve our penetration of both the Chinese and Japanese markets.

Finally, the third big block of initiatives groups all of our wide ranging cost reduction programs. We have targeted improvements in purchasing, the centralization of services and increased overall efficiencies across ST. In order to improve our cost structure, we had to take some painful but indispensable restructuring initiatives, which impacted basically most of our European sites, the Mediterranean basin area and, to some extent, our operations in the USA.

Our roadmap to improved performance has been a huge and complicated undertaking, involving the entire ST organization throughout the world. Every employee, directly or indirectly, has been involved in a well orchestrated performance implying hundreds of simple initiatives that our management team designed and which have been implemented throughout 2005 and as we move into 2006.

New product designs have accelerated. Customer base expansion efforts have been developed and are being carried out. At the same time, cost reduction actions have been implemented across the board.

Also, we would like to highlight that in 2005 the following key organizational changes have been implemented:

We have adjusted our operations and in particular have regrouped under the following new specific organizations:

Front End Technology and R&D;

Home Personal and Communication Products; and

Infrastructure and Services.

We have formed a new Executive Committee, which consists of our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Strategy Officer and three Executive Vice Presidents (representing the Product Group, the Manufacturing organization and the Sales organization); and

We have created a new Greater China Region.

U.S. GAAP and Dutch Statutory Annual Report

We report our quarterly, semi-annual and annual financial results to our investors and the general public using Consolidated Financial Statements prepared under U.S. GAAP, which is the accounting standard we have used since our creation in 1987. We believe that the reference to U.S. GAAP in our financial reporting is important in our industry and in the mind of our investors to ensure the comparability of our performance and results to those of our competitors, and to ensure the continuity in the reporting of our financial performance. We intend to continue using U.S. GAAP as our primary accounting standard for the Company s setting of financial and operational performance targets, and for internal and external reporting purposes. Copies of our U.S. GAAP annual report, based on Form 20-F, quarterly releases and other information, can be obtained from our offices and are also available on ST s website at www.st.com.

By means of regulation 1606/2002, the European Commission has stipulated that all listed companies within the European Union member states are required to prepare their consolidated financial statements under International Financial Reporting Standards (IFRS) as from January 1, 2005. We have therefore, for Dutch statutory purposes, prepared our first annual report based on IFRS. We wish to inform our shareholders that based on the fact that we have started to use IFRS for the first time only since January 1, 2005, we do not yet have systems and controls in place to enable us to accurately compare the figures relating to development expenses for 2004.

Full Year 2005 Results Highlights

During 2005, our performance constantly improved, quarter after quarter, from the bottom levels of the first quarter 2005. Our goal is to continue to strengthen our financial performance and product leadership based upon the execution of our corporate performance roadmap.

Our year-over-year financial results are, for the purposes of the statutory Managing Board Report under Dutch law, presented using IFRS figures.

Our net revenues for the year ended December 31, 2005 were $8,882 million, an increase of 1.4% over the $8,760 million recorded in 2004. Year-over-year sales growth was driven by wireless and data storage applications, which both grew at double-digit rates. Automotive applications also grew at a much faster rate than that of the Company year-over-year.

Gross profit was $3,000 million or 33.8% of net revenues in 2005, compared to $3,195 million, or 36.5% of net revenues in 2004. Operating profit was $394 million, or 4.4% of net revenues, compared to $631 million or 7.2% of net revenues in 2004.

R&D costs for 2005 were $1,411 million, or 15.9% of net revenues, compared to $1,543 million, or 17.6% of net revenues in 2004. However, the 2005 R&D expenses are net of the development capitalization, which started in 2005 and was not considered in the 2004 accounts; furthermore, 2005 R&D expenses included approximately $27 million in charges related to the accelerated vesting of existing stock options. Selling, general, and administrative (SG&A) expenses were $1,069 million or 12.0% of net revenues in 2005, compared to $970 million or 11.1% of net revenues in 2004. 2005 SG&A expenses included

$18 million in one-time compensation and pension charges, $35 million in charges related to the accelerated vesting of stock options and $5 million in other stock-based compensation costs. The Company posted $98 million of impairment, restructuring charges, and other related closure costs in 2005, compared to $85 million in 2004.

Net profit attributable to the shareholders of the Company for 2005 was $347 million, or $0.39 per diluted share. In the prior year, net profit attributable to the shareholders of the Company was $523 million, or $0.56 per diluted share.

For ST, the effective average exchange rate of the euro versus the U.S. dollar for the full year 2005 was approximately $1.28 to 1, which reflects current exchange rate levels and the impact of certain hedging contracts, compared to approximately $1.23 to 1 in 2004.

Net cash from operating activities for 2005 was $1,984 million compared to $2,305 million in 2004. Capital expenditures, net of sales proceeds were $1,441 million in 2005, compared to $2,051 million in 2004. Net operating cash flow for 2005 was $270 million, compared to $208 million in 2004.

Looking towards 2006, we want to share our vision on market trends by making certain forward looking statements which of course are subject to certain risks and uncertainties, highlighted in the Internal Control section.

We expect that 2006 will be a year of renewed sales growth. Our design wins are increasing and should continue to in 2006, together with our sales, as we progress through the year after the seasonal adjustment of the first quarter.

We aim at progressively regaining the market share fractions we have lost over the past several years. We are working to address important business opportunities for us in the areas of wireless, consumer, industrial and, in general, in what we define as the mass market. We are now starting to see the benefits from the marketing initiatives we have been undertaking over the last nine months or so, including the targeting of important new key accounts and specific initiatives for the Japanese and Chinese markets.

We also see 2006 as the year of consolidation of our achievements, the year of further strengthening and of preparation for the next step forward. We are definitely continuing our effort to make ST a sharper research, design, manufacturing and marketing company. We are also addressing other issues in order to protect the Company as much as we can against adverse external conditions.

The impact of currency fluctuations, for example, continues to be a key challenging factor to our cost structure, and we are constantly working to reduce our exposure to that risk. We are acting on several fronts, with Asia playing a central role in these programs. Of course we are increasing the Asian portion of our manufacturing. We are also expanding our supplier base to qualified Asian suppliers. And, where appropriate, we will choose to move to Asia as we have just decided to do for our Corporate Back-End other corporate functions, for which that continent acts as a natural pole of attraction.

We are also working to develop a stronger, more consistent pipeline of new products. A wave of new ST products is hitting the market everyday, now and in these past months starting with our Micro, Linear and Discrete which has had an average of approximately four new products per working day. Here, our effort on advanced analog products for industrial

applications is instrumental for our success in broadening our customer base and enhancing the margin dynamics of that business.

We are also developing complex product platforms which represent some of the most powerful engines for growth of ST. We believe that platforms are the answer to the growing need for full system integration, as customers require from their silicon suppliers not just chips, but an optimized combination of hardware and software. It is a huge task for the industry and it is a major change in the way companies position themselves to better serve their customers.

In ST s case more than 1,500 engineers and designers are currently working on the development of five platforms. We have selected the following platforms, as we believe they are the spearheads of our future growth plans in some of the fastest developing markets for the microelectronics industry:

- Two in the consumer area, include:
  - Set-Top-Boxes, covering both standard and high definition satellite, cable, digital terrestrial and Internet Protocol based devices; and
  - Digital TV, covering integrated and module solutions that capitalize on the ongoing worldwide transition to digital television.
- Two in the wireless area, include:
  - Application Processors, namely our Nomadik platform that is bringing multimedia to the next-generation mobile devices; and
  - Wireless infrastructure, for 3-G base-stations.
- And one platform in the computer peripherals area, is:
  - The SPEAr family of configurable System-on-Chip ICs for printers and related applications.

Needless to say, the complexity of these platforms and the amount of system content they integrate on silicon, are such that they can best be developed in tight cooperation with our customers and alliances. In this respect, ST has pioneered the concept of strategic alliances with customers and has created a solid network of consolidated partnerships, which in the year 2005 contributed to as much as 44% of total revenues, up 5% from the previous year. We also have a long tradition of cooperation with competitors on technology, developments and specific product families, where we join resources to better cater to the markets we serve.

Corporate Governance and Internal Controls

We confirm to our shareholders, and other stakeholders, that management at ST has always devoted the highest importance to corporate governance and internal controls issues. We consider these issues all the more relevant, that as a company subject to the laws of various jurisdictions which may in certain cases have conflicting requirements in terms of best practices, we need to ensure that our position on these important items is well communicated

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and understood. For this reason and for the first time, we are including in our Statutory Annual Report a special section on Corporate Governance and Internal Controls.

Conclusion

We would like to focus the attention of our shareholders and other stakeholders on our corporate culture and our wholehearted commitment to corporate responsibility and sustainable development.

In a moment of profound changes, the attention of ST s management team is on improving the Company s financial performance. But the values we share are there, strong and solid as ever.

We believe that today, and just as in the past, ST will do business with integrity, and that ST is aware of its responsibility towards its stakeholders. Big corporations are powerful, so they must be accountable. Market conditions may change, and they may have an impact on the speed of implementation of our programs. But ST management will not question the direction and the ultimate goal. Our vision is to create value for all of our stakeholders.

Our corporate responsibility action is focused on four main areas:

Integrity, the core of our business ethics, which we see as a deep ethical obligation;

Health and Safety, where we have pioneered OHSAS certifications. Here we would like to go beyond the traditional concept of safety, working at protecting the health of our employees inside and outside their workplace;

Our efforts to help bridge the digital divide; and

Sustainable development and more particularly energy conservation. This is an area where we believe we could, and should do more. We and the entire industry should make a special effort in designing and introducing new products that are more friendly to the environment, particularly in the area of energy savings: from solar cells and fuel cells to fuel-saving engine controls; from low-consumption lighting to more efficient power management controls and, in general, low power technologies. We believe we can contribute to the protection of the environment, while at the same time creating new market opportunities.

We intend to pursue our activities in this field of corporate responsibility throughout 2006 and in the future.

Approved by the Managing Board on March 23, 2006.

CORPORATE GOVERNANCE

Since our formation in 1987, we have demonstrated a consistent commitment to the principles of good corporate governance, evidenced by:

- Our corporate organization under Dutch law that entrusts our management to a Managing Board acting under the supervision and control of a Supervisory Board totally independent from the Managing Board. Members of our Managing Board and of our Supervisory Board are appointed and dismissed by our shareholders;

- Our early adoption of policies on important issues such as business ethics and conflicts of interest and our strict policies, implemented since our 1994 initial public offering, to comply with applicable regulatory requirements concerning financial reporting, insider trading and public disclosures;

- Our compliance with United States, French and Italian securities laws, because our shares are listed in these jurisdictions, and with Dutch securities laws, because we are a company incorporated under the laws of the Netherlands, as well as our compliance with the corporate, social and financial laws applicable to our subsidiaries in the countries in which we do business; and

- Our broad-based activities in the field of corporate social responsibility, encompassing environmental, social, health, safety, educational and other related issues.

As a Dutch company, we became subject to the Dutch Corporate Governance Code effective January 1, 2004. As we are listed on the NYSE, Euronext Paris and the Borsa Italiana in Milan, but not in the Netherlands, our corporate governance principles and guidelines seek to achieve compliance with the relevant practices in a variety of jurisdictions, always keeping in mind the best interests of the shareholders, employees and other stockholders. As a result the corporate governance practices differ in certain cases from the best practices recommended by the Dutch Corporate Governance Code. However, by explaining the corporate governance practices in the Corporate Governance Charter, the Company has endeavored to comply with the Dutch Corporate Governance Code. We have summarized our policies and practices in the field of corporate governance in the ST Corporate Governance Charter, including our corporate organization, the remuneration principles which apply to our Managing and Supervisory Boards, our information policy and our corporate policies relating to business ethics and conflicts of interest. Our Charter was discussed with and approved by our shareholders at our 2004 AGM. The ST Corporate Governance Charter was updated in 2005 and will be further updated and expanded whenever necessary or advisable. We are committed to inform our shareholders of any significant changes in our corporate governance policies and practices at our AGM. Along with our Supervisory Board Charter (which includes the charters of our Supervisory Board Committees) and our Code of Business Conduct and Ethics, the current version of our ST Corporate Governance Charter is posted on our website, at http:/www.st.com/stonline/company/governance/index.htm, and these documents are available in print to any shareholder who may request them.

ST s corporate governance provisions, as highlighted by the ST Corporate Governance and Supervisory Board Charters posted on the website under Corporate Governance can differ from the best practice provisions in the Dutch Corporate Governance Code. The areas concern primarily remuneration, where like many of the Company s peer companies in the

high-tech industry and due to the fiscal legislation in the various main countries in which the Company operates, there is neither a requirement for a minimum three-year vesting period for share-based compensation (best practice provisions II.2.1 and II.2.2 of the Dutch Corporate Governance Code), nor a three-year minimum (five years for Managing Board members) holding requirement (best practice provision II.2.3 of the Dutch Corporate Governance Code). Furthermore, ST believes that Supervisory Board members compensation should include stock-based compensation in order to ensure that they best identify with the interests of all shareholders in line with international practices (best practice provision III.7.1 of the Dutch Corporate Governance Code).

ST s Supervisory Board and Corporate Governance

ST has adopted a profile for its Supervisory Board members, the composition of the Supervisory Board committees, as well as a definition of independence regarding the status of Supervisory Board members which is described in the Supervisory Board Charter. Since the Company s creation in 1987, STMicroelectronics Holding N.V. (ST Holding) has always been one of the major shareholders, and some of the members of the Supervisory Board have long-standing relationships with both the shareholders and with the Company. Such relationships are described in their biographies, which are posted on our website. One of the Company s Supervisory Board members has been in office since 1987, which is more than twelve years (best practice provision III.3.5). Additionally, the Chairman of the Supervisory Board is also the President of the Company s Supervisory Board s Compensation Committee. This is due to the system of alternating the position of President of the Supervisory Board (best practice provision III.5.11 of the Dutch Corporate Governance Code).

The Supervisory Board is carefully selected based upon the combined experience and expertise of its members. Certain of our Supervisory Board members, as disclosed in their biographies attached to the Supervisory Board report, have existing relationships or past relationships with Areva, Cassa Depositi e Prestiti (CDP) and/or Finmeccanica, who are currently parties to the ST Holding Shareholders Agreement as described below. Such relationships may give rise to potential conflicts of interest. However, in fulfilling their duties under Dutch law, Supervisory Board members serve the best interests of all of ST s stakeholders and of ST s business and must act independently in their supervision of ST s management.

Our Supervisory Board held several meetings in 2003, 2004 and 2005 to discuss the new Dutch Corporate Governance Code, the implementing rules and corporate governance standards of the SEC and of the NYSE. It created an Ad Hoc Committee composed of Messrs. de Waard (Chairman), Steve and Gavois. The committee considered our independence criteria, Corporate Governance Charter and Supervisory Board Charter. Based on the work of the Ad Hoc Committee, our Supervisory Board also considered, with respect to such matters, our unique history as a European company incorporated in the Netherlands following the combination of the Italian and French semiconductor businesses and our shareholding structure, with approximately 70% of our shares held by the public and approximately 30% indirectly held by French and Italian state-controlled companies.

Based on all these factors, in 2005, the Supervisory Board established the following independence criteria for its members: Supervisory Board members must have no material relationship with STMicroelectronics N.V., or any of our consolidated subsidiaries, or our management. A material relationship can include commercial, industrial, banking,

consulting, legal, accounting, charitable and familial relationships, among others, but does not include a relationship with direct or indirect shareholders.

The Supervisory Board also adopted specific bars to independence. On that basis, the Supervisory Board in March 2005 concluded, in its business judgment that all members qualified as independent based on the criteria set forth above.

The above mentioned independence criteria differ to a certain extent from best practice provision III.2.2 of the Dutch Corporate Governance Code.

Pursuant to the Dutch Corporate Governance Code, the Company is required to remind its shareholders that the Supervisory Board may, upon request of the Managing Board, decide to authorize the issue of preference shares in order to protect ST against a hostile or unfriendly takeover; the Company views this as an opportunity to create a level playing field for all ST stakeholders, if such an event were to occur.

Commitment to Corporate Governance

We have demonstrated a consistent commitment to the principles of good corporate governance evidenced by our early adoption of policies on important issues such as conflicts of interest. Pursuant to our Supervisory Board Charter, the Supervisory Board is responsible for handling and deciding on potential reported conflicts of interest between the Company on the one hand and members of the Supervisory Board and Managing Board on the other hand.

For example, in 2005 our Managing Board requested that our Supervisory Board decide upon the renewal of a contract for the provision of various telecom-related services with Equant, a subsidiary of France Telecom. One of our Supervisory Board members is Chairman and CEO of France Telecom. The Supervisory Board noted the Managing Board s assessment of the positive commercial benefits of such contract and noted that the contract was concluded at normal and competitive conditions and was based on a long-standing proven business relationship between Equant and us. Additionally in 2005, our Managing Board requested that our Supervisory Board decide upon a development and license agreement to be concluded with Quadrics Limited, a company owned by Alenia Aeronautica that is in turn owned by Finmeccanica, one of our principal shareholders. The Supervisory Board noted that the contract was concluded in the ordinary course of business at normal conditions and that it was considered mutually beneficial for Quadrics Limited and us. Additionally, one of our Supervisory Board members is a member of the Board of Directors of Thomson, which is one of our strategic customers. We believe that the transactions with Thomson are made on an arm s length basis in line with market practices and conditions with neither Thomson nor us benefiting from terms any more favorable than those which could be obtained in a *bona fide* transaction with a third party (best practice provisions III.6.4, II.3.2., II.3.3. and II.3.4. have consequently been complied with).

We prepared and published, in 2004, the Corporate Governance Charter, which explains in detail the corporate organization, the remuneration principles that apply to the Managing and Supervisory Boards, the information policy and highlights the corporate policies relating to business ethics and conflicts of interest. The Corporate Governance Charter, which was approved by the shareholders at the 2004 AGM, and has since been updated, as well as the current policies relating to business ethics and conflict of interest, are available on the Company s website as well as in print to any shareholder who may request a copy.

The Company has applied all best practices provisions and for completeness sake and in accordance with the Dutch Corporate Governance Code, has explained all deviations from the Code in this report. The Company s Corporate Governance Charter and the aforementioned deviations from the Dutch Corporate Governance Code were approved by the 2004 AGM.

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INTERNAL CONTROL

As Sole Member of our Managing Board, Mr. Carlo Bozotti is responsible for the design, implementation and operation of the Company s internal risk management and control systems. Our disclosure controls and procedures are also established and maintained under the responsibility of the Company s Executive Vice President and Chief Financial Officer who reports to Mr. Bozotti.

The objective of the Company s internal controls and procedures is to ensure that material information relating to the Company and its consolidated subsidiaries is made known to the Chief Executive Officer and the Chief Financial Officer during each reporting period.

The effectiveness of the Company s internal controls and procedures is evaluated periodically, and changes to such internal controls and procedures, as well as any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to affect the Company s ability to record, process or summarize and report financial information are disclosed to our auditors and to the Audit Committee of our Supervisory Board. Likewise any fraud, whether or not material, that involves management or other employees who have a significant role in the Company s internal control over financial reporting are disclosed to our auditors, and to the Audit Committee of our Supervisory Board. To date in our ongoing evaluation, we have not detected any material weaknesses regarding our system of internal controls.

In the various areas of business risk management we have established corporate policies and procedures which set forth principles, business rules of behavior and conduct which are considered to be consistent with proper business management, in line with our mission and strategic objectives.

We have also adopted Corporate Standard Operating Procedures to describe the operational flow of actions (outlining responsibilities for each step) to perform a task or activity, or to implement a policy within a given functional field. We have over one hundred standard operating procedures which cover a wide range of activities such as approvals, authorizations, verifications, reconciliations, review of operating performance, security of assets and segregation of duties, which are deployed throughout our organization, and which may be completed as and when required by local operating procedures.

We also have an internal audit organization, which performs general scope internal audits covering various areas, such as information technology, logistics and inventory management, human resources and payroll, internal control systems, security, purchasing, treasury, *etc*. The audit plans for our internal audit organization are reviewed at least once a year by the Audit Committee of our Supervisory Board.

Summary

In summary, our internal risk management and control system cannot provide absolute assurance, but aims at a reasonable level of assurance, that realization of strategic and operational objectives is monitored, the financial reporting is reliable and where relevant applicable laws and regulations are complied with.

In accordance with the requirements of recommendation II.1.4 of the Dutch Corporate Governance Code and the recommendation of the Corporate Governance Code Monitoring

Committee on the application thereof, the Managing Board, to the best of its knowledge, believes that with regard to financial reporting risks, our internal risk management and controls systems provide a reasonable level of assurance that that they do not contain material inaccuracies, have operated effectively in the year 2005 and that there are no indications that they will not operate properly in the current year. Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements, fraud and non-compliance with laws and regulations. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to the financial statement preparation and presentation.

The aforementioned statement does not imply a statement regarding the adequacy and effectiveness of the Company s internal controls over financial reporting as will be required by the Sarbanes-Oxley Act section 404, when it applies to the Company as from January 1st 2006.

Our internal risk management and control systems were discussed with the Audit Committee and the Supervisory Board.

Main Risks Factors

The business performance and results of ST and the ability of management to predict the future are also affected by several risks factors such as those described below:

- future developments of the world semiconductor market, in particular the future demand for semiconductor products in the key application markets and from key customers served by our products;
- pricing pressures, losses or curtailments of purchases from key customers;
- the financial impact of inadequate or excess inventories if actual demand differs from our anticipations;
- changes in the exchange rates between the U.S. dollar and the euro and between the U.S. dollar and the currencies of the other major countries in which we have our operating infrastructure;
- our ability to be successful in our strategic R&D initiatives to develop new products to meet anticipated market demand, as well as our ability to achieve our corporate performance roadmap by completing successfully and in a timely manner our other various announced initiatives to improve our overall efficiency and our financial performance;
- the anticipated benefits of R&D alliances and cooperative activities and the continued pursuit of our various alliances, in the field of development of new advanced technologies or products;
- the ability of our suppliers to meet our demands for products and to offer competitive pricing;

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- changes in the economic, social or political environment, as well as natural events such as severe weather, health risks, epidemics or earthquakes in the countries in which we and our key customers operate;

- changes in our overall tax position as a result of changes in tax laws or the outcome of tax audits;

- product liability or warranty claims for a product containing one of our parts; and

- our ability to obtain required licenses on third-party intellectual property, the outcome of litigation and the results of actions by our competitors.

Our Annual Report filed with the SEC on March 3, 2006 under cover of Form 20-F, which is available on our website, contains a more detailed list of risk factors which may affect our business and operations, and future performance.

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EXECUTIVE SUMMARY

We are a multinational group of companies that designs, develops, manufactures and markets a broad range of semiconductor products used in a wide variety of microelectronic applications, including automotive products, computer peripherals, telecommunications systems, consumer products, industrial automation and control systems.

We were incorporated under the law of the Netherlands by notarial deed of incorporation of May 21, 1987. We are a limited liability company (*naamloze vennootschap*) and are governed by Dutch law, including but not limited to Book 2 of the Dutch Civil Code. As a result of the listings of our shares on Euronext Paris, the Borsa Italiana and the New York Stock Exchange, we are also subject to French, Italian and United States rules relating thereto. Furthermore, we are subject to elements of the legislation of all the jurisdictions in which we operate. We have our corporate legal seat in Amsterdam and our head offices at WTC Schiphol Airport, Schiphol Boulevard 265, 1118 BH Schiphol Airport, Amsterdam, The Netherlands.

While STMicroelectronics N.V. is the parent company, we also conduct our operations through our consolidated subsidiaries. Except for our subsidiaries in Shenzhen (China), in which we own 60% of the shares and voting rights, Accent S.r.l. (Italy), in which we own 51% of the shares and voting rights, Hynix, ST (China) venture company in which we own a 33% equity participation, Shanghai Blue Media Co. Ltd (China) in which we own 65% and Incard do Brazil in which we own 50% of the shares and voting rights, STMicroelectronics N.V. owns directly or indirectly 100% of all of our significant operating subsidiaries shares and voting rights. Each subsidiary has its own organization and management bodies, and is operated independently in compliance with the laws of their country of incorporation. We provide certain administrative, human resources, legal, treasury, strategy, manufacturing, marketing and other overhead services to our consolidated subsidiaries pursuant to service agreements for which we receive compensation. The simplified organigram below shows the principal industrial subsidiaries of ST:

According to provisional industry data published by iSuppli, we have been ranked the world s fifth largest semiconductor company based on forecasted 2005 total market sales and we held leading positions in sales of Analog Products, Application Specific Integrated Circuits (or ASICs) and Application Specific Standard Products (or ASSPs). Based on provisional 2005 results published by iSuppli, we believe we were also number one in discretes and number two in automotive electronics, industrial products and analog products and number three in NOR Flash. Based on 2004 industry results, we also believe we ranked as a leading supplier of semiconductors in 2005 for set-top boxes, Smart cards and power management devices. Furthermore, based on our relationship with Hewlett-Packard, which has a leading position in the printhead market, we believe that we are a leading supplier of integrated circuits for printheads. Major customers include Axalto, Alcatel, Bosch, Delphi, Delta, Ericsson, Hewlett-Packard, LG Electronics, Marelli, Maxtor, Motorola, Nokia, Philips, Pioneer, Samsung, Scientific Atlanta, Seagate, Siemens, Thomson, Vestel, Visteon and Western Digital. We also sell our products through global distributors and retailers, including Arrow Electronics, Avnet, BSI Group, Wintech and Yosun.

The semiconductor industry has historically been a cyclical one and we have responded through emphasizing balance in our product portfolio, in the applications we serve, and in the regional markets we address. Consequently, from 1994 through 2005, our revenues grew at a compounded annual growth rate of 11.6% compared to 7.6% for the industry as a whole.

We offer a diversified product portfolio and develop products for a wide range of market applications to reduce our dependence on any single product, application or end market. Within our diversified portfolio, we have focused on developing products that leverage our technological strengths in creating customized, system-level solutions with high-growth digital and mixed-signal content. Our product families include differentiated application specific products (which we define as being our dedicated analog, mixed signal and digital ASIC and ASSP offerings and semicustom devices), power microcontrollers and discrete products and non-volatile memory and Smart cards. Application specific products, which are generally less vulnerable to market cycles than standard commodity products, accounted for approximately 56% of our net revenues in 2005. Memory product sales accounted for approximately 22% of our net revenues in 2005, while sales of Micro linear and discrete products accounted for approximately 21% of our net revenues in 2005.

Our products are manufactured and designed using a broad range of manufacturing processes and proprietary design methods. We use all of the prevalent function-oriented process technologies, including complementary metal-on silicon oxide semiconductor (CMOS), bipolar and nonvolatile memory technologies. In addition, by combining basic processes, we have developed advanced systems-oriented technologies that enable us to produce differentiated and application specific products, including bipolar CMOS technologies (BiCMOS) for mixed-signal applications and diffused metal-on silicon oxide semiconductor (DMOS) technology (BCD technologies) for intelligent power applications and embedded memory technologies. This broad technology portfolio, a cornerstone of our strategy for many years, enables us to meet the increasing demand for System-on-Chip (SoC) solutions. Complementing this depth and diversity of process and design technology is our broad intellectual property portfolio that we also use to enter into important patent cross-licensing agreements with other major semiconductor companies.

Effective January 1, 2005, we realigned our product groups to increase market focus and realize the full potential of our products, technologies and sales and marketing channels. Since such date we report our sales and operating profit in three product segments:

- the Application Specific Product Group (ASG) segment, comprised of three product lines our Home, Personal and Communication Products (HPC), our Computer Peripherals Products (CPG) and our Automotive Product (APG). Our HPC products are comprised of the telecommunications and the audio divisions from the former Telecommunications, Peripherals and Automotive Groups combined with the consumer group from the former Consumer Microcontroller Groups. Our CPG products cover computer peripherals products, specifically disk drives and printers, and our APG products now comprise all of our major complex products related to automotive applications formerly within the automotive group of Telecommunications, Peripherals and Automotive Groups and in other product groups (notably from the former Discrete and Standard ICs Group and the Microcontroller Group);

- the Memory Products Group (MPG) segment, comprised of our memories and Smart card businesses; and

- the Micro, Linear and Discrete Product Group (MLD) segment, comprised of the greater part of our former Discrete and Standard ICs Group and our standard microcontroller and industrial devices (including the programmable systems memories (PSM) division previously forming part of MPG).

Our principal investment and resource allocation decisions in the semiconductor business area are for expenditures on R&D and capital investments in front-end and back-end manufacturing facilities. These decisions are not made by product segments, but on the basis of the semiconductor business area. All these product segments share common R&D for process technology and manufacturing capacity for most of their products.

We have in 2005 pursued various initiatives to reshape the Company by: (i) reorganizing our management team and setting up an Executive Committee; (ii) increasing our R&D effectiveness through a program focus on 20 key initiatives, improved project control and redeployment of certain resources with the aim to improve time to market for both technologies and products; (iii) promoting sales expansion for mass market application and new major key accounts with a special focus on the Chinese and Japanese markets with a view to increased overall efficiencies; (iv) executing a plan to improve our manufacturing competitiveness through the restructuring of our 150-mm wafer production capacity and (v) launching and implementing various further cost reduction initiatives through procurement savings, improved asset management, general and administration centralization and head count restructuring.

We invest in a variety of R&D projects ranging from long-term advanced research for the acceleration, in line with industry requirements and roadmaps such as the International Technology Roadmap for Semiconductors (ITRS), of our broad range of process technologies including BiCMOS; bipolar, CMOS and DMOS (BCD); High Performance Logic; and stand-alone and embedded Flash and other nonvolatile memories; to the continued expansion of our system level design expertise and IP creation for advanced architecture for SoC integration, as well as new products for many key applications in the field of digital consumer wireless communications and networking, computer peripherals, Smart cards and car multimedia among others.

We continue to make significant investments in R&D, while reducing our other general expenses. In 2005, we spent $1,411 million on R&D compared to $1,543 million in 2004.

Our reported R&D expenses are mainly in the areas of product design, technology and development and do not include marketing design center costs, which are accounted for as selling expenses, or process engineering, pre-production and process-transfer costs, which are accounted for as cost of sales.

As of December 31, 2005, approximately 9,700 employees were employed in R&D activities worldwide. We devote significant effort to R&D because semiconductor manufacturers face immense pressure to be the first to make breakthroughs that can be leveraged into competitive advantages; new developments in semiconductor technology can make end products significantly cheaper, faster or more reliable than their predecessors and enable, through their timely appearance on the market, significant value creation opportunities.

As of December 31, 2005, the average age of our 50,000 employees was 33.9 years and the voluntary turn-over rate was 7.8%, compared to an average age of 33.7 years and a voluntary turn-over rate of 6.6% as of December 31, 2004.

Major Shareholders

The following table sets forth certain information with respect to the ownership of our issued ordinary shares based on information available to us as of December 31, 2005:

	Ordinary Shares Owned	
Shareholders(1)	**Number**	**%**
STMicroelectronics Holding II B.V. (ST Holding II)	250,704,754	27.6%
Public[1]	580,787,153	63.9%
Brandes Investment Partners	62,932,372	7%
Treasury shares	13,400,000	1.5%

(1) At the end of 2004, Capital Group International, Inc. owned more than 5% of our share capital. As of December 31, 2005, Capital Group International, Inc. had reduced its participation in our share capital below the 5% threshold and is, consequently, no longer one of our major shareholders.

Our principal shareholders do not have different voting rights from those of our other shareholders.

ST Holding II is a wholly-owned subsidiary of STMicroelectronics Holding N.V. (ST Holding). As of December 31, 2005, FT1CI (the French Shareholder) and a consortium of Italian shareholders (the Italian Shareholders) made up of CDP and Finmeccanica directly held 50% each in ST Holding based on voting rights. CDP held 30% in ST Holding and Finmeccanica held 20% in ST Holding based on voting rights. The indirect interest of FT1CI and the Italian Shareholders is split on a 50%-50% basis. Through a structured tracking stock system implemented in the articles of

association of ST Holding and ST Holding II, FT1CI indirectly held 99,318,236 of our ordinary shares, representing 10.9% of our issued share capital as of December 31, 2005, CDP indirectly held 91,644,941 of our ordinary shares, representing 10.1% of our issued share capital as of December 31, 2005 and Finmeccanica indirectly held 59,741,577 of our ordinary shares, representing 6.6% of our issued share capital as of December 31, 2005. Any disposals or, as the case may be, acquisitions by ST Holding II on behalf of respectively FT1CI, CDP and Finmeccanica, will decrease or, as the case may be, increase the indirect interest of respectively FT1CI, CDP and Finmeccanica in our issued share capital. FT1CI was formerly a jointly held company set up

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by Areva and France Telecom to control the interest of the French shareholders in ST Holding. Following the transactions described below, Areva is currently the sole shareholder of FT1CI. Areva (formerly known as CEA-Industrie) is a corporation controlled by the French atomic energy commission. Areva is listed on Euronext Paris in the form of Investment Certificates. CDP is an Italian corporation 70% owned by the Italian *Ministero dell Economia e delle Finanze* (the Ministry of Economy and Finance) and 30% owned by a consortium of 66 Italian banking foundations. Finmeccanica is a listed Italian holding company owned by the Italian Ministry of Economy, which has a controlling interest, and the public. Finmeccanica is listed on the Italian Mercato Telematico Azionario (MTA) and is included in the S&P/MIB 30 stock index.

ST Holding II owned 90% of our shares before our initial public offering in 1994, and has since then gradually reduced its participation, going below the 66% threshold in 1997 and below the 50% threshold in 1999. ST Holding may further dispose its shares as provided below in Shareholders Agreements STH Shareholders Agreement and Disposals of our Ordinary Shares and pursuant to the eventual conversion of our outstanding convertible instruments.

Set forth below is a table of ST Holding II s holdings in us as of the end of each of the past three financial years:

	Ordinary Shares Owned	
	Number	**%**
December 31, 2005	250,704,754	27.6
December 31, 2004	278,483,280	30.8
December 31, 2003	311,483,280	34.5

Announcements about additional disposals of our shares by ST Holding II on behalf of one or more of its indirect shareholders, Areva, CDP, FT1CI or Finmeccanica may come at any time.

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The chart below illustrates the shareholding structure as of December 31, 2005:

(1) CDP owns 30% of ST Holding, while Finmeccanica owns 20% of ST Holding.

(2) Not a legal entity, purely for illustrative purposes.

(3) FT1CI owns 50% of ST Holding and indirectly holds 99,318,236 of our ordinary shares.

(4) CDP and Finmeccanica own 50% of ST Holding and indirectly hold 91,644,941 and 59,741,577 of our ordinary shares, respectively.

(5) The 70.9% includes the 7% shareholding of Brandes Investment Partners.

(6) ST Holding II owns 27.6% of our shares, the Public owns 70.9% of our shares and we hold the remaining 1.5% as Treasury

Shares.

Strategy

The semiconductor industry is undergoing several significant structural changes characterized by:

- the changing long-term structural growth of the overall market for semiconductor products;
- the strong development of new emerging applications in areas such as wireless communications, solid state storage, digital TV and video products and games;
- the increasing importance of the Asia Pacific region and emerging countries, particularly China, which represents the fastest growing regional market;
- the importance of convergence between wireless consumer and computer applications, which drives customer demand for new system-level, turnkey solutions; and
- the evolution of the customer base from original equipment manufacturers (OEM) to a mix of OEM, electronic manufacturing service providers (EMS) and original design manufacturers (ODM).

Our strategy within this challenging environment is designed to focus on the following complementary key elements:
Broad, balanced market exposure. We offer a diversified product portfolio and develop products for a wide range of market applications, thereby reducing our dependence on any single product, application or end market. Within our diversified portfolio, we have focused on developing products that leverage our technological strengths in creating customized, system-level solutions for high-growth digital and mixed-signal applications. We target five key markets comprised of: (i) communications, including wireless connectivity, mobile phone imaging, portable multimedia and infrastructure; (ii) computer peripherals, including data storage, printers, monitors, displays and optical mouse; (iii) digital consumer, including set-top boxes, DVD, digital TVs, digital cameras and digital audio; (iv) automotive, including engine, body and safety, car radio, car multimedia and telematics; and (v) industrial products, including banking, user ID/security, telephone Smart card, power management and industrial control.
Product strategy. We aim to: (i) maintain existing and further establish leadership positions for platforms and chipset solutions for digital consumer, wireless and multimedia digital core offerings; (ii) maintain a leadership position in conventional semiconductor products such as discretes for power management, automotive and analog and mixed signal applications, which require less R&D effort and manufacturing capital intensity than more advanced and complex application specific devices; and (iii) participate, as appropriate, in the nonvolatile memory market for selected key applications.
Alliances and customer base expansion. We work with our key customers to identify evolving needs and new applications and to develop innovative products and product features. We also leverage our position as a supplier of application specific products in seeking to sell a broad range of products and emphasize strategic customer alliances to expand our customer base. We have formal alliances with certain strategic customers that allow us and our customers (with whom we jointly share certain product developments) to exchange information and give our customers access to our process technologies and manufacturing infrastructure. We have formed alliances with customers such as Alcatel, Bosch, Hewlett-Packard, Marelli, Nokia, Nortel, Pioneer, Seagate, Siemens VDO, Thomson and Western Digital, among others. Our twelve strategic alliances with key customers have been a major growth driver for us. In 2003, 2004 and 2005, revenues from strategic customer alliances accounted for approximately 43%, 39% and 44%, respectively, of our net revenues. We are targeting new major key accounts, particularly in the United States and in the Asia Pacific region, with a focus on China and Japan where we are also developing specific marketing efforts to increase our market penetration. Furthermore, we have set up a new organization with specific e-tools, design and support resources to address broader market applications.
Global integrated manufacturing infrastructure. We have a diversified, leading edge manufacturing infrastructure capable of producing silicon wafers using our broad process technology portfolio, including our CMOS, BiCMOS, BCD technologies and memories. Assembling, testing and packaging of our semiconductor products take place in our large and modern back-end facilities, which generally are located in low-cost areas. We have also developed relationships with outside contractors for foundry and back-end services. We view these relationships as giving us the flexibility when required by market demand to outsource up to a maximum of 20% of each of our front-end and back-end production requirements, enabling us to manage the supply chain to our customers without a commensurate increase in

capital spending. In 2005, we decided to combine our front-end manufacturing and our technology R&D into one organization in order to improve our manufacturing competitiveness and efficiency and our technology R&D effectiveness. In the current competitive environment, we have launched various cost reduction initiatives in the area of manufacturing and our strategy consists of: (i) establishing in the Asia Pacific region the major portion of our 150-mm manufacturing activity; (ii) organizing our 200-mm manufacturing to increase operational efficiency through yield improvements, improved leverage due to reduced depreciation from mature assets and full saturation of all clean room areas; (iii) addressing the projected increase in demand for 300-mm manufacturing through an appropriate ramp-up of internal capacity; and (iv) gaining flexibility in terms of capacity needs and employed capital through selected sourcing from foundry manufacturers.

Industry partnerships. Partnerships with other semiconductor companies and suppliers enable us to share the increasing costs and technological risks involved in the R&D of state-of-the-art processes, product architectures and digital cores and to shorten the product development time of certain products. For example, we are currently working under a joint R&D technology cooperation program with Freescale Semiconductor, Inc. (Freescale) and Philips Semiconductors International B.V. (Philips) for the joint R&D of CMOS process technology in Crolles, France (Crolles2). In 2005, we extended this agreement to cover 300-mm wafer testing and packaging, as well as the development and licensing of core libraries and IP. Additionally, we are co-developing NAND Flash memory products with Hynix Semiconductor Inc. (Hynix) and have started to build a jointly owned dedicated memory manufacturing facility in China. Furthermore, we recently announced an agreement with Intel Corporation (Intel) to standardize hardware and software interfaces used in leading edge NOR Flash products in the wireless market and are working on various further initiatives.

Broad range of design and process technologies. We continue to utilize our expertise and experience with a wide range of process and design technologies to further develop our capabilities. We are committed to maintaining and, in certain areas, to increasing expenditures on core R&D projects as well as to developing alliances with other semiconductor companies and suppliers of software development tools, as appropriate. In 2005, we redeployed approximately 1,000 employees or 10% of our R&D work force to emphasize our focus and commitment to higher priority projects. Technological advances in the areas of transistor performance and interconnection technologies are being developed for our CMOS logic products and semicustom devices. We work on an ongoing basis with key suppliers to develop advanced and standardized design methodologies for our CMOS, mixed signal and non-volatile memory processes, as well as libraries of macrofunctions and megafunctions for many of our products, and are focusing on improving our concurrent engineering practices to better coordinate design activities and reduce overall product development time.

Integrated presence in key regional markets. We have sought to develop a competitive advantage by building an integrated presence in each of the world s major economic zones: Europe, Asia (including China), North America and Emerging Markets. An integrated presence means having manufacturing and design, as well as sales and marketing capabilities in each region, in order to ensure that we are well positioned to anticipate and respond to our customers business requirements. We have leading edge, front-end manufacturing facilities in Europe, in the United States and increasingly in Asia, where we sourced from internal and external manufacturers approximately 44% of our wafers at the end of 2005. Our more labor-

intensive back-end facilities are located in Malaysia, Malta, Morocco, Singapore and China, enabling us to take advantage of more favorable production cost structures, particularly lower labor costs. Major design centers and local sales and marketing groups are within close proximity of key customers in each region, which we believe enhances our ability to maintain strong relationships with our customers. As appropriate, we intend to continue to build our integrated local presence in those regions where we compete, such as China, which has recently been set up as a separate marketing region and where we have both a back-end facility and a design center and have started to build with Hynix a jointly owned front-end memory manufacturing plant in Wuxi City, as well as India, where we have been expanding our design and software development centers. We have also continued to develop our sales and support organization for Emerging Markets.

Product Quality Excellence.

We aim to develop a product of quality excellence in the various applications we serve and are planning the launch of a company-wide Product Quality Awareness program built around a three-pronged approach: (i) the improvement of our full product cycle involving robust design and manufacturing, improved detection of potential defects, and better anticipation of failures through improved risk assessment, particularly in the areas of product and process changes; (ii) improved responsiveness to customer demands; and (iii) ever increasing focus on quality and discipline in execution.

2005 Business Overview

In 2005, the semiconductor market experienced a moderate increase in total sales after the strong growth recorded in 2004. Semiconductor industry data for 2005 indicates that revenues improved supported by a solid economic environment in the major world economies.

The total available market is defined as the TAM , while the serviceable available market, the SAM , is defined as the market for products produced by us (which consists of the TAM and excludes PC motherboard major devices such as microprocessors (MPU), dynamic random access memories (DRAMs), and optoelectronics devices).

Based upon recently published data, semiconductor industry revenues increased year-over-year by approximately 7% both for the TAM and the SAM in 2005, to reach $227.5 billion and approximately $152 billion, respectively. This increase was driven by unit demand while average selling prices remained basically flat. In the fourth quarter of 2005, the TAM and the SAM increased approximately 9% and 13% year-over-year, respectively, and increased by approximately 2% and 3% sequentially, respectively.

Our 2005 revenues were characterized by significant high volume demand and improved product mix, which did not translate into an equivalent revenue performance due to persisting negative impact of price pressure in the market we serve. As a result, our revenues increased by approximately 1% to $8,882 million compared to $8,760 million in 2004. Our sales growth was driven primarily by Computer Peripherals, Telecom and Automotive market segments while both Consumer and Industrial and Other declined. Our sales trend, however, was below the TAM and the SAM growth rates.

In summary, our financial results for 2005 compared to the results of 2004 were favorably impacted by the following factors:

- higher sales volume and a more favorable product mix in our revenues, which contributed to an increase in our net revenues over 2004;
- continuous improvement of our manufacturing performances;
- net interest income; and
- lower income tax expense.

Our financial results in 2005 were negatively affected by the following factors:

- negative pricing trends due to a persisting overcapacity in the industry, which translated into our average selling prices declining by approximately 8%, as a pure pricing effect;
- the impact of the effective U.S. dollar exchange rate against the euro and other currencies, which translated into an increase of our cost of sales and in our operating expenses being significantly higher than the favorable impact on our revenues;
- the one-time compensation packages and special bonuses to our former CEO and to a limited number of retired senior executives, the new pension scheme charges for executive management and the share-based compensation charges for non-vested shares granted to employees and members and professionals of our Supervisory Board for a total of $37 million;
- the acceleration of the vesting of all outstanding share options; and
- the recognition of interest charges on our 2013 convertible debt, starting from 2005, due to the split of the liability component.

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LIQUIDITY AND FINANCIAL POSITION

At December 31, 2005, cash and cash equivalents totaled $2,027 million, compared to $1,950 million as of December 31, 2004. During 2005, we invested in credit-linked deposits issued by several primary banks in order to maximize the return on available cash. The principal was fully repaid to us in December 2005. We did not have marketable securities at December 31, 2005 as well as at December 31, 2004. Changes in the instruments adopted to invest our liquidity in future periods may occur and may significantly affect our finance income (costs).

Liquidity

We maintain a significant cash position and a low debt to equity ratio, which provide us with adequate financial flexibility. As in the past, our cash management policy is to finance our investment needs mainly with net cash generated from operating activities.

Net cash from operating activities. As in prior periods, the major source of cash during 2005 was cash provided by operating activities. Our net cash from operating activities totaled $1,984 million in 2005, decreasing compared to $2,305 million in 2004.

Net cash used in investing activities. Net cash used in investing activities was $1,714 million in 2005, compared to $2,097 million in 2004. Payments for purchases of tangible assets were the main utilization of cash, amounting to $1,523 million for 2005, a significant decrease over the $2,061 million in 2004. In 2005, cash used for investments in intangible assets and financial assets was $287 million and capital contributions to associates were $38 million.

Capital expenditures for 2005 were principally allocated to:

- the capacity expansion of our 200-mm and 150-mm front-end facilities in Singapore;
- the conversion to 200-mm of our front-end facility in Agrate (Italy);
- the capacity expansion of our back-end plants in Muar (Malaysia), Shenzhen (China), Toa Payoh (Singapore) and Malta;
- the expansion of our 200-mm front-end facility in Phoenix (Arizona);
- the capacity expansion of our 200-mm front-end facility in Rousset (France);
- the completion of building and continuation of facilities for our 300-mm front-end plant in Catania (Italy);
- the expansion of our 150-mm front-end facility and the start of a 200-mm pilot line in Tours (France); and
- the expansion of the 300-mm front-end joint project with Philips Semiconductor International B.V. and Freescale Semiconductor Inc., in Crolles2 (France).

Capital expenditures for 2004 were principally allocated to:

- the expansion of our 200-mm and 150-mm front-end facilities in Singapore;

the expansion of our 200-mm front-end facility in Rousset (France);

the facilitization of our 300-mm facility in Catania (Italy);

the upgrading of our front-end facility and R&D pilot line in Agrate (Italy);

the upgrading of our 200-mm front-end facility in Catania (Italy);

the expansion and upgrading of our 200-mm and 150-mm, respectively, front-end facilities in Phoenix and in Carrollton (United States); and

the capacity expansion in our back-end plants in Muar (Malaysia), Toa Payoh (Singapore), Shenzhen (China) and Malta.

Net operating cash flow. We define net operating cash flow as net cash from operating activities minus net cash used in investing activities, excluding payment for purchases of and proceeds from the sale of marketable securities. We believe net operating cash flow provides useful information for investors because it measures our capacity to generate cash from our operating activities to sustain our investments for our operating activities. Net operating cash flow is determined as follows from our Consolidated Statements of Cash Flow:

	2005	2004
Net cash from operating activities	$ 1,984	$ 2,305
Net cash used in investing activities	(1,714)	(2,097)
Payment for purchase and proceeds from sale of marketable securities, net		
Net operating cash flow	$ 270	$ 208

Due to the capacity of our operating activities to generate cash in excess of our investing activities, we generated net operating cash flow of $270 million in 2005, compared to net operating cash flow of $208 million in 2004. This resulted mainly from the decrease in net cash used in investing activities.

Net cash used in financing activities. Net cash used in financing activities was $131 million in 2005 compared to $1,281 million in 2004. The major item of the cash used in 2005 was the payment of the dividends amounting to $107 million, equivalent to the amount paid in 2004. The major item of the cash used for financing activities in 2004 was the repayment of long-term debt for a total amount of $1,288 million, mainly consisting of the redemption of all outstanding 2009 LYONs for an amount paid of $813 million and of the repurchase of all outstanding 2010 Bonds for an amount paid of $375 million. These bonds were cancelled.

Capital Resources

Net financial position

We define our net financial position as the difference between our total cash position (cash and cash equivalents) net of total financial debt (bank overdrafts, current portion of long-term debt and long-term debt). We believe our net financial position provides useful information for investors because it gives evidence of our global position either in terms of net

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indebtedness or net cash by measuring our capital resources based on cash and cash equivalents and the total level of our financial indebtedness. The net financial position is determined as follows from our Consolidated Balance Sheets as at December 31, 2005 and December 31, 2004:

	2005	2004
Cash and cash equivalents	$ 2,027	$ 1,950
Marketable securities		
Total cash position	2,027	1,950
Bank overdrafts	(11)	(58)
Current portion of long-term debt	(1,499)	(133)
Long-term debt	(269)	(1,767)
Total financial debt	(1,779)	(1,958)
Net financial position	$ 248	$ (8)

The net financial position (cash and cash equivalents net of total financial debt) as of December 31, 2005 moved to a positive net financial cash position of $248 million, representing an improvement from the net financial debt position of $8 million as of December 31, 2004. The improvement of the net financial position mainly results from favorable net operating cash flow generated during 2005.

At December 31, 2005, the aggregate amount of our long-term debt was approximately $1,768 million, including $1,356 million of 2013 Bonds. At the holder s option, any outstanding 2013 Bond may be redeemed for cash on August 5, 2006, 2008 or 2010 for a total aggregate amount payable by us of $1,379 million on August 5, 2006 or $1,365 million on August 5, 2008 or $1,352 million on August 5, 2010. See Note 14 to our Consolidated Financial Statements.

On February 23, 2006, we issued Zero Coupon Senior Convertible Bonds due 2016 totaling gross proceeds of $928 million. The amount due to bondholders upon redemption or at maturity based on the accreted value of the bonds will produce a yield equivalent to 1.5% per annum on a semi-annual bond equivalent basis. We granted the managers an option to increase the issue size by up to 5%, totaling $46 million, through March 24, 2006. The bonds are convertible into a maximum of 42 million of our underlying ordinary shares, including the increase option. The conversion price is $23.19, based on the closing price of ordinary shares on the NYSE on February 14, 2006, plus a 30% premium.

On March 17, 2006, we issued 500 million Floating Rate Senior Bonds due 2013 in the Euro Debt Capital Market. These bonds will pay interest quarterly at a rate equal to three-month Euribor plus 40 basis points.

Financial Outlook

We currently expect that capital spending for 2006 will be approximately $1.8 billion, an increase compared to the $1.4 billion net of sales proceeds spent in 2005. The major part of our capital spending will be dedicated to the leading edge technology fabs by increasing 300-mm capacity and by saturating our existing 200-mm fabs. We have the flexibility to modulate our investments up or down in response to changes in market conditions. At December 31, 2005, we had $576 million in outstanding commitments for equipment purchases for 2006.

The most significant of our 2006 capital expenditure projects are expected to be: (a) for the front-end facilities: (i) the expansion of the 300-mm joint project with Philips Semiconductor International B.V. and Freescale Semiconductor Inc., in Crolles2 (France); (ii) the facilitization of a portion of our 300-mm plant in Catania (Italy); (iii) the upgrading to finer geometry technologies for our 200-mm plant in Rousset (France); (iv) the capacity expansion and the upgrading of our 200-mm plant in Singapore; and (v) the upgrading of our 200-mm fab and pilot line in Agrate (Italy); and (b) for the back-end facilities, the capital expenditures will be mainly dedicated to the capacity expansion in our plants in Shenzhen (China), Bouskoura (Morocco) and Muar (Malaysia). We will continue to monitor our level of capital spending by taking into consideration factors such as trends in the semiconductor industry, capacity utilization and announced additions. We expect to have significant capital requirements in the coming years and in addition we intend to continue to devote a substantial portion of our net revenues to R&D . We plan to fund our capital requirements from cash provided by operating activities, available funds and available support from third parties (including state support), and may have recourse to borrowings under available credit lines and, to the extent necessary or attractive based on market conditions prevailing at the time, the issuing of debt, convertible bonds or additional equity securities. A substantial deterioration of our economic results and consequently of our profitability could generate a deterioration of the cash generated by our operating activities. Therefore, there can be no assurance that, in future periods, we will generate the same level of cash as in the previous years to fund our capital expenditures for expansion plans, our working capital requirements, R&D and industrialization costs.

The holders of our 2013 Bonds may require us to redeem them on August 5, 2006 at a price of $985.09 per $1,000 face value. The conversion ratio is $985.09 per $1,000 principal amount of 2013 Bonds at August 5, 2006, $975.28 at August 5, 2008 and $965.56 at August 5, 2010, subject to adjustments in certain circumstances. The total redeemable amount will be equivalent to $1,379 million on August 5, 2006. As part of our refinancing strategy, we recently issued 500 million Floating Rate Senior Bonds due 2013 in the Euro Debt Capital Market. This issuance complemented our recent placement of $928 million of Zero Coupon Senior Convertible Bonds due 2016. To the extent that we do not use the proceeds from both of these offerings for the repayment of amounts due under the 2013 Bonds or for repurchases of the 2013 Bonds, we will use the proceeds for general corporate purposes.

Market Risk About Financial Instruments

We are exposed to changes in financial market conditions in the normal course of business due to our operations in different foreign currencies and our ongoing investing and financing activities. Market risk is the uncertainty to which future earnings or asset/liability values are exposed due to operating cash flows denominated in foreign currencies and various financial instruments used in the normal course of operations. The major risks to which we are exposed are related to the fluctuations of the U.S. dollar exchange rate compared to the euro and the other major currencies, the coverage of our foreign currency exposures, the variation of the interest rates and the risks associated to the investments of our available cash. We have established policies, procedures and internal processes governing our management of market risks and the use of financial instruments to manage our exposure to such risks.

Our Income Statement is exposed to the fluctuations of the exchange rates such as the U.S. dollar, the euro and the other major currencies since our revenues are mainly denominated in U.S. dollars while a large part of our costs is denominated in euros or other major currencies. We enter into cash flow hedges to cover a portion of our costs denominated in euros. Our

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balance sheet is also exposed to these exchange rates fluctuations since the functional currency of our subsidiaries is generally the local currency and as such, foreign exchange fluctuations are generating adjustments for the translation into U.S. dollar consolidated reporting of their assets and liabilities.

We have exposures in foreign currencies since our operating cash flows are denominated in various foreign currencies as a result of our international business activities and certain of our borrowings are exposed to changes in foreign exchange rates. The functional currency of our subsidiaries is either the local currency or the U.S. dollar. We continuously evaluate our foreign currency exposures based on current market conditions and the business environment. In order to mitigate the impact of changes in foreign currency exchange rates, we enter into forward exchange and currency options contracts. The magnitude and nature of such outstanding instruments are detailed in Note 28 to our Consolidated Financial Statements. Forward contracts outstanding as of December 31, 2005 have remaining terms of four days to five months, which mature on average after less than two months. The notional amounts of foreign exchange forward contracts totaled $2,206 million and $8,852 million at December 31, 2005 and 2004, respectively. The principal currencies covered are the U.S. dollar, the euro, the Japanese yen and the Singapore dollar. The risk of loss associated with these forward contracts is equal to the exchange rate differential from the date the contract is made until the time it is settled.

We are exposed to changes in interest rates primarily as a result of our borrowing activities which include long-term debt used to fund business operations. We borrow in U.S. dollars as well as in other currencies from banks and other sources. We primarily enter into debt obligations to support general corporate and local purposes including capital expenditures and working capital needs. The nature and amount of our long-term debt can be expected to vary as a result of future business requirements, market conditions, and other factors. The principal risks are related to interest rates variations to which we are exposed in regard to our long-term obligations. We primarily utilize fixed-rate debt and do not expect changes in interest rates to have a material effect on income or cash flows in 2006.

We place our cash and cash equivalents, or a part of it, with high credit quality financial institutions with at least a single A rating, mainly on a short-term basis; as such we are exposed to the fluctuations of the market interest rates on our placement and our cash, which can have an impact on our accounts. We manage the credit risks associated with financial instruments through credit approvals, investment limits and centralized monitoring procedures but do not normally require collateral or other security from the parties to the financial instruments.

We do not anticipate any material adverse effect on our financial position, result of operations or cash flows resulting from the use of our instruments in the future. There can be no assurance that these strategies will be effective or that transaction losses can be minimized or forecasted accurately.

The information below summarizes our market risks associated with cash equivalents, debt obligations, and other significant financial instruments as of December 31, 2005. The information below should be read in conjunction with Note 28 to the Consolidated Financial Statements.

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CONSOLIDATED FINANCIAL STATEMENTS

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STMICROELECTRONICS N.V. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

In million of U.S. dollars except per share amounts	Note	Year ended December 31, 2005	December 31, 2004
Sales		8,876	8,756
Other revenues		6	4
Total revenues		**8,882**	**8,760**
Cost of sales	20	(5,882)	(5,565)
Gross profit		**3,000**	**3,195**
Selling, general and administrative	20	(1,069)	(970)
Research and development	20	(1,411)	(1,543)
Other income	18	104	147
Other expenses	18	(132)	(113)
Impairment, restructuring charges and other related closure costs	19	(98)	(85)
Operating profit		**394**	**631**
Finance income	21	53	41
Finance cost	21	(57)	(47)
Share of loss of associates	3	(3)	(4)
Profit before income taxes		**387**	**621**
Income tax expense	22	(39)	(95)
Net profit		**348**	**526**
Attributable to:			
Shareholders of the Company		**347**	**523**
Minority interest		**1**	**3**
Earnings per share (Basic)	**17**	**0.39**	**0.59**
Earnings per share (Diluted)	**17**	**0.39**	**0.56**

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

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STMICROELECTRONICS N.V. AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

		As at	
In million of U.S. dollars	**Note**	**December 31, 2005**	**December 31, 2004**
ASSETS			
Non-current assets:			
Property, plant and equipment	10	6,179	7,446
Goodwill	8	174	188
Other intangible assets	9	458	291
Deferred income tax assets	22	160	145
Investments in associates	3	35	6
Investments and other non-current assets	11	118	111
Total non-current assets		**7,124**	**8,187**
Current assets:			
Inventories	6	1,413	1,348
Trade accounts receivable	5	1,490	1,408
Derivative financial instruments	28	3	200
Other receivables and assets	7	586	643
Cash and cash equivalents	23	2,027	1,950
Total current assets		**5,519**	**5,549**
TOTAL ASSETS		**12,643**	**13,736**
LIABILITIES AND EQUITY			
Equity attributable to the shareholders of the Company	15	8,650	9,028
Minority interests		50	48
Total equity		**8,700**	**9,076**
Liabilities			
Non-current liabilities:			
Long-term debt	14	269	1,767
Retirement benefit obligations	13	300	303
Deferred income tax liabilities	22	83	80
Other non-current liabilities		16	15
Total non-current liabilities		**668**	**2,165**
Current liabilities:			
Current portion of long-term debt	14	1,499	133

Trade accounts payable		965	1,352
Derivative financial instruments	28	31	109
Other payables, accrued liabilities and provisions	12	617	667
Current income tax liabilities		152	176
Bank overdrafts		11	58
		3,275	**2,495**
Total liabilities		**3,943**	**4,660**
TOTAL LIABILITIES AND EQUITY		**12,643**	**13,736**

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

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STMICROELECTRONICS N.V. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

		Equity attributable to the shareholders of the Company						
In million of U.S. dollars, except per share amounts	**Note**	**Ordinary Shares**	**Capital Surplus**	**Treasury Shares**	**Retained Earnings**	**Other Reserves**	**Minority Interests**	**Total Equity**
Balance as of January 1, 2004		**1,146**	**1,905**	**(348)**	**4,652**	**684**	**45**	**8,084**
Unrealized loss on available-for-sale financial assets, net of tax	16					(3)		(3)
Unrealized gain on cash flow hedge, net of tax	16					59		59
Foreign currency translation difference	16					440		440
Net income recognized directly in equity						*496*		*496*
Net profit					523		3	526
Total recognized income for 2004					523	496	3	1,022
Employee share award scheme:								
Value of services provided	15					54		54
Exercise of share options	15	4	19					23
Dividends, $0.12 per share	16				(107)			(107)
		4	19		(107)	54		(30)
Balance as of December 31, 2004		**1,150**	**1,924**	**(348)**	**5,068**	**1,234**	**48**	**9,076**
Convertible debt-Equity component	14				(54)	114		60
Adjusted balance as of January 1, 2005		**1,150**	**1,924**	**(348)**	**5,014**	**1,348**	**48**	**9,136**
Unrealized loss on cash flow hedge, net of tax	16					(67)		(67)
Foreign currency translation difference	16					(764)	1	(763)
Net income recognized directly in equity						*(831)*	*1*	*(830)*
Net profit					347		1	348
Total recognized income for 2005					**347**	**(831)**	**2**	**(482)**
Employee share award scheme:								
Value of services provided	15					118		118
Exercise of stock options	15	3	32					35
Dividends, $0.12 per share	16				(107)			(107)
		3	**32**		**(107)**	**118**		**46**

Balance as of December 31, 2005	**1,153**	**1,956**	**(348)**	**5,254**	**635**	**50**	**8,700**

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

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STMICROELECTRONICS N.V. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

		Year ended	
In million of U.S. dollars	**Note**	**December 31, 2005**	**December 31, 2004**
Cash flows from operating activities:			
Cash generated from operations	24	2,091	2,405
Interest paid		(17)	(16)
Income tax paid		(90)	(84)
Net cash from operating activities		**1,984**	**2,305**
Cash flows from investing activities:			
Acquisition of subsidiaries			(3)
Payment for purchase of tangible assets	10	(1,523)	(2,061)
Proceeds from the sale of tangible assets	10	82	10
Investment in intangible and financial assets	9, 11	(287)	(79)
Capital contributions to associates	3	(38)	(2)
Interest received		52	38
Net cash used in investing activities		**(1,714)**	**(2,097)**
Cash flows from financing activities:			
Proceeds from issuance of ordinary shares	15	35	23
Proceeds from issuance of long-term debt	14	50	91
Repayment of long-term debt	14	(110)	(1,288)
Dividends paid to the Company s shareholders	16	(107)	(107)
Other financing activities		1	
Net cash used in financing activities		**(131)**	**(1,281)**
Effect of changes in exchange rates		(15)	12
Net cash increase (decrease)		**124**	**(1,061)**
Cash and cash equivalents at beginning of period		**1,892**	**2,953**
Cash and cash equivalents at end of period		**2,016**	**1,892**
Reconciliation of cash and cash equivalents			
Cash and cash equivalents for balance sheet purposes		2,027	1,950
Bank overdrafts		(11)	(58)

Cash and cash equivalents for cash flow statement purposes	**2,016**	**1,892**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in millions of U.S. dollars, except per share amounts)

1 GENERAL INFORMATION

STMicroelectronics N.V. (the Company) is registered in The Netherlands with its statutory domicile in Amsterdam. The Company was formed in 1987 to be the holding company for the combination of the semiconductor business of SGS Microelettronica (then owned by Società Finanziaria 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 and its subsidiaries (together the Group) are a global independent semiconductor company that designs, develops, manufactures and markets a broad range of semiconductor integrated circuits (ICs) and discrete devices. The Group offers a diversified product portfolio and develops products for a wide range of market applications, including automotive products, computer peripherals, telecommunications systems, consumer products, industrial automation and control systems. Within its diversified portfolio, the Group has focused on developing products that leverage its technological strengths in creating customized, system-level solutions with high-growth digital and mixed-signal content.

These financial statements have been approved for issue by the Supervisory Board on March 23, 2006.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements, prepared for Dutch statutory purposes, have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. In accordance with Article 402, Title 9, Book 2 of the Dutch Civil Code the statement of income is presented in abbreviated form for the Company s accounts further presented in these statutory financial statements.

All balances and values in the current and prior periods are in millions of dollars, except share and per-share amounts. Under Article 35 of the Company s Articles of Association, the financial year extends from January 1 to December 31, which is the period-end of each fiscal year.

For internal and external reporting purposes, the Group follows accounting principles generally accepted in the United States of America (U.S. GAAP). U.S. GAAP is the Group s primary accounting standard for the setting of financial and operational performance targets.

The consolidated financial statements have been prepared under the historical cost convention, as modified by available-for-sale financial assets and certain financial assets and financial liabilities (including derivative instruments) at fair value. The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group s accounting policies. The areas involving a higher degree of judgment

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or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 2.22.

First-time Adoption of IFRS

Historically, the Group has prepared its consolidated financial statements under accounting principles generally accepted in the Netherlands (Dutch GAAP). By means of regulation 1606/2002, the European Commission has stipulated that all listed companies within the European Union member states are required to prepare their consolidated financial statements under IFRS from January 1, 2005. Hence, the Group has prepared its first annual report under IFRS as endorsed by the European Commission. As the Group publishes comparative information for one year in its annual report, the transition date to IFRS is January 1, 2004. The financial information has been prepared on the basis of all IFRS standards effective and endorsed by the European Commission as of December 31, 2005, with certain standards being early adopted by the Group where stated in these consolidated financial statements. IFRS 1, *First-time Adoption of International Financial Reporting Standards* (IFRS 1), allows the Group to elect to use one or more exemptions from IFRS in its transition. The Group has elected to apply the following exemptions:

The Group has not retrospectively applied IFRS 3, *Business Combinations*, to acquisitions prior to the transition date. Consequently business combinations recognized before January 1, 2004 have not been restated;

The application of IFRS 2, *Share-based Payment*, and the related interpretations, has been limited to awards granted after November 7, 2002 and not fully vested as at January 1, 2005;

The Group has not restated the comparative 2004 consolidated financial statements for the impact of IAS 32, *Financial Instruments: Disclosure and Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement* and the related amendments.

The Group has applied prospectively from the IFRS transition date the corridor approach in the accounting for actuarial gains and losses on its retirement benefit obligations. As such, the cumulative unrecognized loss related to its defined benefit plans was recognized in net equity in its opening consolidated balance sheet.

To the extent that the accounting principles previously applied under Dutch GAAP differ from the accounting principles as prescribed under IFRS, the Group has adjusted its accounting policies. The main impact of the adoption of IFRS is in the areas that are discussed below.

Reconciliation at January 1, 2004, December 31, 2004 and January 1, 2005

		January 1, 2004	**December 31, 2004**	**January 1, 2005**
Consolidated shareholders equity under Dutch GAAP		**8,024**	**8,981**	**8,981**
Goodwill amortization, net of tax	(a)		52	52
Restructuring charges, net of tax	(b)	21		
Share-based payment, net of tax	(c)	2	4	4

		January 1, 2004	December 31, 2004	January 1, 2005
Pension costs, net of tax	(d)	(22)	(12)	(12)
Borrowing costs, net of tax	(e)	2	3	3
Deferred tax computation	(f)	13		
Convertible debt, net of tax	(g)			60
Consolidated shareholders equity under IFRS		**8,040**	**9,028**	**9,088**

Reconciliation of profit attributable to the shareholders of the Group for the year ended December 31, 2004

		December 31, 2004
Consolidated net profit attributable to the shareholders of the Group under Dutch GAAP		**549**
Goodwill amortization, net of tax	(a)	52
Restructuring charges, net of tax	(b)	(21)
Share-based payment, net of tax	(c)	(52)
Pension cost, net of tax	(d)	7
Borrowing costs, net of tax	(e)	1
Deferred tax computation	(f)	(13)
Consolidated net profit attributable to the shareholders of the Group under IFRS		**523**

(a) Goodwill amortization

Under Dutch GAAP, goodwill recognized on business combinations is amortized over its useful life. When applying IAS 36 (revised), *Impairment of Assets*, goodwill is not amortized but rather is subject to an impairment test. As a result, the Group reversed the 2004 goodwill amortization recorded under Dutch GAAP amounting to $52 million.

(b) Restructuring charges Termination benefits

The Group applies IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* for the recognition of provision for restructuring charges, including involuntary termination benefits.

In 2003, the Group committed to a plan to restructure its 150mm front-end manufacturing operations and part of its back-end operations in order to improve cost competitiveness. Pursuant to this plan, the Group recorded under Dutch GAAP as at December 31, 2003 a provision amounting approximately to $21 million net of tax ($31 million before tax), for contractual and legal involuntary termination benefits for an estimated number of employees at two of its European subsidiaries. The plan was formally communicated to employees only in 2004. IAS 37 requires the Group to communicate the details of the restructuring plan to the affected employees prior to recording a provision. Consequently, under IAS 37, the provision was reversed in opening equity at January 1, 2004 and recorded in the consolidated statement of income in 2004.

(c) Share-based Payment

At January 1, 2004, the Group had five stock-based employee and Supervisory Board stock-option plans. Previously under Dutch GAAP, the Group applied the intrinsic-value-based

method in accounting for stock-based awards to employees. No stock-based employee compensation cost was reflected in net profit, as all options under those plans were granted at an exercise price equal to the market value of the underlying ordinary shares on the date of grant. With the adoption of IFRS, the Group applies IFRS 2, *Share-based Payment* (IFRS 2) in accounting for share-based awards, which requires the measurement of the cost of share-based service awards according to the grant-date fair value of the award. The cost is recognized ratably over the period during which an employee is required to provide service in exchange for the award or the requisite service period, which usually corresponds to the vesting period.

Pursuant to IFRS 1 optional exemptions, the Group has elected to record compensation cost only for share-based awards granted after November 7, 2002 and not fully vested as at January 1, 2005. Expensing the fair value of share-based awards granted has ultimately no impact on total shareholders equity as the associated credit is directly to equity, although timing differences can occur between periods. The Group s adoption of IFRS 2 at the transition date resulted in an adjustment to opening equity of $2 million for share-based compensation expense capitalized as part of inventory. The Group recorded share-based compensation cost of $54 million for the year ended December 31, 2004, of which $4 million was capitalized as part of inventory.

(d) Pension benefits

The $22 million difference at the IFRS transition date relates to the following:

a. Historically under Dutch GAAP the Group recorded an additional minimum pension liability adjustment for the unfunded portion of the accumulated benefit obligation of its defined benefit pension plans, which is not required under IFRS. Dutch GAAP requires the portion of this additional minimum liability exceeding unrecognized prior service cost to be recorded directly to equity. Therefore, $37 million has been reversed in the IFRS opening balance sheet at the IFRS transition date corresponding to this additional minimum pension liability for a GBP-denominated defined beneft plan.

b. The Company has elected the optional exemption on transition to IFRS and has applied the corridor approach prospectively from January 1, 2004. Consequently, a charge of $57 million net of tax was recorded as of the IFRS transition date representing the net cumulative amount of unrecognized actuarial losses.

c. When reviewing its pension schemes, the Group has identified certain components of pension costs for which the accounting treatment was different under IAS 19, *Employee Benefits* and recorded a charge of $2 million in its consolidated financial statements as of January 1, 2004.

The reconciling difference was decreased by $10 million at December 31, 2004 to reach $12 million. The decrease relates to:

An adjustment of $3 million to reverse the additional foreign currency translation adjustment (CTA) generated by the GBP-denominated defined benefit plan for the additional minimum pension liability recorded in Dutch GAAP.

The measurement of and timing recognition for certain elements of some defined benefit plans, such as valuation and limitation of pension assets, recognition of prior service cost or transition amounts that have generated differences representing a positive impact of $7 million.

(e) Borrowing costs

Pursuant to the adoption of IAS 23, *Borrowing Costs*, the Group elected to capitalize interest cost directly attributable to the acquisition or construction of an asset on all qualifying assets. Historically, under Dutch GAAP, the Group had elected to capitalize interest cost on material assets only. Consequently, the Group capitalized $2 million interest expense, after tax, on its consolidated balance sheet as of the IFRS transition date. For the year ended December 31, 2004, the Group capitalized borrowing costs for an additional $1 million.

(f) Deferred tax computation

A positive adjustment of $13 million was recorded in the IFRS opening balance sheet corresponding to the computation in one of the local tax jurisdictions of the Group of deferred tax assets and liabilities based on the new tax rate substantively enacted in 2003, while under Dutch GAAP, only tax laws and tax rates enacted at the balance sheet date was used to measure deferred tax assets and liabilities. Since the tax rate was enacted in 2004, there is no longer a reconciling item as of December 31, 2004.

(g) Convertible debt

Under IFRS, compound financial instruments must be analyzed into debt and equity components based on the circumstances at the inception of the instruments. The fair value of the liability portion of the convertible debt was determined using a market interest rate for an equivalent non-convertible debt over the period of future probable cash flows as estimated on the date of issuance. This was determined to be a three-year timeframe corresponding to the period to the first date of redemption for cash at the option of the holder. This amount is recognized as a liability on an amortized cost basis until redeemed, extinguished on conversion or on the maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. The embedded rights of the bond holder to extend the bond beyond the probable three year period, by not exercising their redemption option, are measured at fair value through profit and loss.

Debt issuance and other transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Only the costs allocated to the liability component of the financial instrument are amortized in finance cost until the first redemption option right of the holder.

In application of the first-time adoption requirements as set out in IFRS 1, the Group separated the equity and liability components of the convertible debt at the debt issuance. This resulted in a $60 million net impact to equity at January 1, 2005, which was composed of $114 million of the equity component and related issuance costs ($136 million of the equity component gross of $22 million of premiums and related issuance costs already accounted for in the previous years) and $54 million of cumulative interest expense.

Cash Flow under IFRS

In the transition to IFRS, the major impact on cash flow statement under IFRS is the capitalization of the development costs, which are now included as cash flows from investing activities as opposed to cash flows from operating activities.

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2.1 Principles of consolidation

The Group s consolidated financial statements include the assets, liabilities, results of operations and cash flows of its majority-owned subsidiaries. The ownership of other interest holders is reflected as minority interests. Intergroup balances and transactions have been eliminated in consolidation.

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of any minority interest. The excess of the cost of acquisition over the fair value of the Company s share of the identifiable net assets acquired is recorded as goodwill (Note 2.12). If the cost of acquisition is lower than the fair value of the Company s share in the net assets of the entity acquired, the difference is recognized directly in the income statement.

(b) Associates

Associates include all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. These investments are accounted for by the equity method of accounting and are initially recognized at cost. They are presented on the face of the consolidated balance sheet as Investments in associates .

The Group s share in its associates profit and losses is recognized in the income statement as Shares of loss of associates and in the balance sheet as an adjustment against the carrying amount of the associate. When the Group s share of losses in an associate equals or exceeds its interest in the associate, including any unsecured receivable, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

2.2 Foreign currency

The U.S. dollar is the presentation currency for the Group and the functional currency for the Company, which is the currency of the primary economic environment in which the Company operates. The worldwide semiconductor industry uses the U.S. dollar as a currency of reference for actual pricing in the market. Furthermore, the majority of the Group s transactions are denominated in U.S. dollars, and revenues from external sales in U.S. dollars largely exceed revenues in any other currency. However, labor costs are concentrated primarily in the countries that have adopted the Euro currency.

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For consolidation purposes, assets and liabilities included in the financial statements of the Company s subsidiaries are measured using the currency of the primary economic environment in which the entity operates and are translated at current rates of exchange at the balance sheet date. Income and expense items and cash flow items are translated at the monthly average exchange rate of the period. The effects of translating the financial position and results of operations from local functional currencies are reported as a component of other reserves in the consolidated statements of changes in equity.

Assets, liabilities, revenues, expenses, gains or losses arising from foreign currency transactions are recorded in the functional currency of the recording entity at the exchange rate during the month of the transaction. At each balance sheet date, recorded balances denominated in a currency other than the recording entity s functional currency are remeasured into the functional currency at the exchange rate prevailing at the balance sheet date. The related exchange gains and losses are recorded in the consolidated statements of income.

2.3 Revenue Recognition

Revenue comprises the fair value of the sale of goods and services, net of value-added tax, rebates and discounts and after eliminating intercompany sales within the Group. Revenue is recognized as follows:

(a) Sales

Revenue from the sale of products is recognized upon transfer of significant risks and rewards of ownership to the customer. This usually occurs at the time of shipment. Distribution costs are recorded in cost of sales .

(b) Other revenues

Other revenues primarily consist of license revenue and patent royalty income, which are recognized ratably over the term of the agreements.

(c) Fundings

Fundings received by the Group are mainly from governmental agencies and income is recorded when all qualifying expenditures have been performed and the Group has obtained sufficient evidence from the relevant authorities that the credit will be granted. The Group s primary sources for government funding are French, Italian and other European Union (EU) governmental entities, and Singapore agencies. Such funding is generally provided to encourage research and development activities, industrialization and local economic development. The EU has developed model contracts for research and development funding that require beneficiaries to disclose the results to third parties on reasonable terms. The conditions for receipt of government funding may include eligibility restrictions, approval by EU authorities, annual budget appropriations, compliance with European Commission regulations, as well as specifications regarding objectives and results. Certain specific contracts contain obligations to maintain a minimum level of employment and investment during a certain period of time. There could be penalties if these objectives are not fulfilled. Other contracts contain penalties for late deliveries or for breach of contract, which may result in repayment obligations. In accordance with the Group s revenue recognition policy, funding related to these contracts is recorded when the conditions required by the contracts

are met. The Group s funding programs are classified under three general categories: funding for research and development activities, capital investment, and loans.

Funding for research and development activities is the most common form of funding that the Group receives. Public funding for such activities is recorded as other income in the Group s consolidated statements of income. Public funding is recognized ratably as the related costs are incurred once the agreement with the respective governmental agency has been signed and all applicable conditions are met. No major public funding is received for development projects recognized by the Group as intangible assets, which would have supposed that the Group would have recognized such funding as a reduction of the corresponding intangible assets.

The Group receives certain specific project-related research tax credits in one of its European tax jurisdictions. Such credits can be recovered through the reduction of income tax to be paid for the year. Nevertheless, the Group is entitled to receive in cash such credit even if no income tax is expected to be paid. As such the Group recognizes these credits as research and development funding, which are included in other income in the consolidated statements of income.

Capital investment funding is recorded as a reduction of property, plant and equipment and is recognized in the Group s consolidated statements of income according to the depreciation charges of the funded assets during their useful lives. The Group also receives capital funding in Italy, which is recovered through the reduction of various government liabilities, including income taxes, value-added tax and employee-related social charges. The funding has been classified as long-term receivable and is reflected in the balance sheet at its discounted net present value. The subsequent accretion of the discount is recorded as non-operating profit in Finance cost .

The Group receives certain loans, mainly related to large capital investment projects, at preferential interest rates. The Group records these loans at their nominal value as debt in its consolidated balance sheets, which has also been determined to approximate its effective rate based on the term outstanding.

2.4 Research and development

Research and development expenditures include costs incurred by the Group, the Group s share of costs incurred by other research and development interest groups and costs associated with co-development contracts. Research and development expenses do not include marketing design center costs, which are accounted for as selling expenses and process engineering, pre-production or process transfer costs which are recorded as cost of sales. Research costs are charged to expense as incurred.

Expenditures incurred on development projects, mainly related to the design and testing of new or improved products, are recognized as intangible assets when it is probable that the project will be a success, considering its commercial and technological feasibility, and costs can be measured reliably. Development expenditures recognized as assets are amortized over their estimated useful lives, not exceeding three years (Note 2.11). Other development costs are recognized as an expense as incurred. Development costs recognized as an expense are not recognized as an asset in a subsequent period. The amortization expense recognized on capitalized development costs is recorded as cost of sales. Amortization expense on technologies and licenses purchased by the Group from third parties to facilitate the Group s research is recorded as research and development expenses.

2.5 Start-up costs

Start-up costs represent costs incurred in the start-up and testing of the Group s new manufacturing facilities, before reaching the earlier of a minimum level of production or 6-months after the fabrication line s quality qualification. No sales are associated with these costs. As such, they are not included as part of cost of sales and are presented in other expenses in the consolidated statements of income.

2.6 Income taxes

Income tax expense represents the income taxes expected to be paid or the benefit expected to be received related to the current year income or loss in each individual tax jurisdiction. Income tax expense for specific tax assessments are also estimated and recorded when an additional tax payment is determined probable. Deferred tax assets and liabilities are recorded, using the liability method, for temporary differences arising between the tax and book bases of assets and liabilities and for the benefits of tax credits and operating loss carry-forwards. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. The Group does not provide deferred income taxes on temporary differences arising on investments in subsidiaries and associates because the timing of the reversal of the temporary difference is controlled by the Group, and it is probable that the temporary difference will not reverse in the foreseeable future, or if reversed, will not be subject to tax.

Certain specific research tax credits received in one of the European tax jurisdictions of the Group are recognized as research and development funding and included in other income in the consolidated statements of income since the Group is entitled to receive in cash such credit even if no income tax is expected to be paid for the year in which the research tax credit must be recognized.

2.7 Earnings per share

Basic earnings per share are computed by dividing net profit by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are computed using the treasury stock method by dividing net profit (adding-back interest expense, net of tax effects, related to convertible debt if determined to be dilutive) by the weighted average number of ordinary shares and potential ordinary shares outstanding during the period. The weighted average shares used to compute diluted earnings per share include the incremental shares of ordinary shares relating to stock options granted, nonvested shares and convertible debt to the extent such incremental shares are dilutive. Nonvested shares with performance or market conditions are included in the computation of diluted earnings per share if their conditions have been satisfied at the balance sheet date and if the awards are dilutive.

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2.8 Cash and cash equivalents

Cash and cash equivalents represents cash on hand, deposits at call with banks, highly liquid investments with insignificant interest rate risk purchased with an original maturity of ninety days or less. For cash flow presentation purposes, cash and cash equivalents includes bank overdrafts. Bank overdrafts are shown as part of current liabilities on the consolidated balance sheets.

2.9 Trade accounts receivable

The accounts receivable are initially recognized at fair value, and subsequently measured at amortized cost using the effective interest method, net of allowances for doubtful accounts. The Group maintains an allowance for doubtful accounts for estimated losses resulting from its customers inability to make required payments. The amount of provision is the difference between the asset s carrying amount and the present value of the estimated present cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statement as selling, general and administrative expenses .

2.10 Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is based on the weighted average cost by adjusting standard cost to approximate actual manufacturing costs on a quarterly basis; the cost is therefore dependent on the Group s manufacturing performance. In the case of underutilization of manufacturing facilities, the costs associated with the excess capacity are not included in the valuation of inventories but charged directly to cost of sales. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Additionally, the Group evaluates its product inventory to identify obsolete or slow-selling stock. The Group also identifies any excess uncommitted inventory based on the previous quarter sales, orders backlog and production plans. Inventory associated with obsolete or uncommitted inventory is expensed to cost of sales.

2.11 Intangible assets subject to amortization

Intangible assets subject to amortization include the cost of technologies and licenses purchased from third parties, purchased software, internally developed software which is capitalized and costs incurred on other development projects that meet all capitalization criteria as defined in IAS 38 (revised), *Intangible Assets*. Intangible assets subject to amortization are reflected net of any impairment losses. The carrying value of intangible assets subject to amortization is evaluated whenever changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized in the income statement for the amount by which the asset s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset s fair value and value in use. The fair value which would normally be estimated based on independent market appraisals has not been used by the Group as market appraisals have not been feasible for the Group s intangible assets. The value in use corresponds to the sum of discounted future cash flows to be derived from the particular asset or to the cash-regenerating unit to which it relates.

Amortization is computed using the straight-line method over the following estimated useful lives:

Technologies & licenses	3-7 years
Purchased software	3-4 years
Internally developed software	4 years
Capitalized development costs	3 years

The Group evaluates the remaining useful life of an intangible asset at each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization.
The capitalization of costs for internally generated software developed for the Group s internal use begins when preliminary project stage is completed and when the Group, implicitly or explicitly, authorizes and commits to funding a computer software project. It must be probable that the project will be completed and will be used to perform the function intended.
Expenditures incurred on development projects, mainly related to the design and testing of new or improved products, are recognised as intangible assets net of any material government funding directly attributable to the specific projects when the Group can demonstrate all of the following: (i) the technical feasibility of completing the item under development so th