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# Shareholder Information

## Letters to our Shareholders



Dear shareholders,

As Dialog Semiconductor's Chief Executive Officer, I welcome this opportunity to update you on our company's progress in this last year and to offer you our outlook for the medium term.

This time last year I indicated that Dialog would be able to pursue a number of higher growth opportunities in the mobile phone, consumer electronics and automotive systems markets, providing our company was properly positioned to embrace these opportunities.

During 2006 your Board has worked hard to prepare and position Dialog for such growth. We have invested significant resources in these efforts, working directly with a number of lead customers to gain further traction within important growth markets.

In the previous communications I have also pointed to a number of key challenges facing Dialog in the years ahead, namely:

- Customer concentration
- Improving our cost platform
- Strengthening the Board and management
- Focusing product and sales on higher growth markets

In line with our strategy, I am pleased to report that we have made significant progress this year in addressing these challenges.

Firstly, our decision in September 2006 to transition our final test operations from Germany to off-shore subcontractors in Asia has provided Dialog with a key platform on which we can build a scaleable business; avoid capital expenditure on big ticket test equipment; and improve our total manufacturing cycle time.

We have steadily gained new customer design wins in Asia and North America during the year, whilst at the same time broadening our focus beyond the mainstream cell-phone segment to include smart-phones as well as other lithium-ion battery operated consumer products.

We have also attracted significant industry talent and expertise to Dialog, strengthening our capacity to deliver on our strategy and building further management depth in our newly formed Business Units as well as Field Applications, Product Marketing and Finance functions.

Against this backdrop of strategic repositioning, FY 2006 was – as forecast – disappointing in terms of financial performance.

In addition to our strategic decision to reduce Dialog's exposure to volatile and unprofitable commodity LCD driver markets, which resulted in inventory write-downs, the main contributors to this performance were the unforeseen insolvency of our major wireless customer – BenQ Mobile GmbH, plus the delay in mobile phone market transition from 2G to 3G technology.

In the fourth quarter 2006, we also decided to de-list the Company from the NASDAQ stock exchange. Given the very low volume of trading in Dialog ADRs on NASDAQ, this decision will help in simplifying the complexity of our financial reporting and reducing our costs.

The decision to offshore our test operations as well as the decision to de-list from NASDAQ prove Dialog's commitment to create a lower cost platform for growth in light of these challenges. Given the tough competitive environment in 2006, we continue to improve business practices and operational efficiencies. As a result Dialog enters 2007 with low inventory, zero debt and a higher level of cash than with which it started 2006.

During the year Dialog has focused its R&D effort on producing world-class technology, in the shape of an increasingly broad base of products, from which to generate future returns for its shareholders. Furthermore, Dialog has not just maintained but has expanded its relationship base to count some of the industry's best names amongst its partners and customers.

Whilst our 2G products reached end of life in 2006, resulting in a sharp drop in Wireless product sales for the year, we have developed a growing portfolio of highly integrated power management and audio products for 3G/HSDPA mobile phones and application processor based Smart Phones with several tier 1 customers. In addition, we have produced new power management and innovative low power display drivers for portable consumer electronics markets. This range of new products in both established and emerging sectors will provide the company with new growth opportunities from the second half of 2007.

Our portfolio of Automotive and Industrial products covering highly integrated smart motor controllers and electronic lamp ballast products produced solid revenues in 2006, in line with expectations. Throughout the year we achieved further custom IC design wins, with both new and existing customers, bolstering our confidence that these products will continue to provide a

dependable and growing revenue stream in the years ahead.

Going forward, we will continue our efforts to fine-tune Dialog's strategy and make changes to ensure that the company is well positioned to deliver sustainable growth in revenue and profits for the benefit of all our shareholders. For the remainder of 2007 our focus will be on developing and implementing the following strategic actions:

- Create further Application Specific Standard Products. Our focus will be to partner with complimentary lead players in each segment such as Smart Phones, Multimedia and GPS and leverage these new channels to market.
- Maintain and extend our lead in power management, HiFi audio, and high voltage mixed signal Systems on Chip (SOC).
- Extend our sales, marketing and technical support to clients outside Europe with a focus on US, Japan, and the Asia Pacific region.
- Consolidate the cost gains from transition to a complete fabless model with our subcontractor partners.
- Continue to recruit the industry's best talent in order to ensure Dialog's continued progress and further improve Dialog's ability to realise its potential.

Creating sustainable shareholder value lies at the very heart of our strategy and to this end we view sustainable *profitable* growth as a key objective. Dialog is now a more focused company in terms of its fabless business model. Dialog's exploitation of our core competency of power and energy management positions us well in the key growth segments of the market, pointing to improved gross product margins for the longer term.

Crucially 2006 was a year of strategic change at Dialog; change which we continue to consolidate. Your Board sees 2007 as a year of execution and growth, although we expect 1H07 market conditions to follow those seen in 4Q06. In 2007 we will be building on the strategic changes we have already made and moving towards sustainable growth for the long term.

I am extremely impressed with the professionalism and dedication displayed by our employees throughout this year of change and - as a result of their efforts - I have confidence in Dialog's future.

Sincerely yours,

Dr. Jalal Bagherli, CEO

Dear Shareholders,

The Board of Dialog is acutely aware that 2006 was a difficult and disappointing year for the Company.

During the course of the year the Board has sought to encourage, evaluate and monitor the changes required in the Company. As a result significant changes have been made; both strategic, such as ceasing involvement in standard displays and the spin-out of the camera division, and operational, such as the outsourcing of testing and other operations.

Dr. Jalal Bagherli has been tenacious and tireless in his efforts to implement change. With a great deal of understanding combined with a sense of urgency he has brought the senior executives and employees with him on this journey and they are now equally enthused by the change process and fully supporting him in his efforts. As a result I am excited about our prospects. That said, 2007 also will be a year of transition towards achievement of the Company's strategic goals and of producing long-term sustainable profitable growth.

Change in the Company in 2006 has not just been confined to strategic and operational issues; albeit that these changes are key to our future success. In line with an overall review of the Company there have been other significant changes.

2006 has seen important new appointments to the Board with Peter Weber, Peter Tan, Russ Shaw and Chris Burke joining. I am delighted that such high calibre individuals have joined us. They are each enthused by the prospects of supporting our CEO in his turn around in the fortunes of the Company.

In 2006 we de-listed from NASDAQ. We are sorry to lose some of our US shareholders. Some, I am delighted to say, remain with us on the Frankfurt exchange.

The decision to de-list from NASDAQ was not taken lightly. The Board considered that the financial resource required to comply with the increasing regulatory burden of the listing could be more profitably utilised in seeking to achieve our strategic goals. More importantly, the increased management time ensuring regulatory compliance was felt a distraction from the key task of implementing the changes required in the Company.

The Company appreciates the importance of business controls and checks and is committed to having suitable control processes in place throughout its operations.

My message to you, our shareholders, is that whilst 2006 was a difficult and disappointing year and 2007 will see further transition, the Company is being repositioned to achieve future sustainable growth and enhanced shareholder value.

Greg Reyes  
Chairman

## The Dialog Semiconductor Share in 2006

### Investment case

Dialog Semiconductor has a strong track record in the development and supply of state-of-the-art power management, audio and display driver technology and has built a global reputation as a supplier of superior products to the wireless and automotive industries. Dialog's core competence is its focus on innovative mixed signal standard products as well as application specific IC solutions manufactured entirely in CMOS technology.

Dialog's products enhance the performance and features of wireless, hand-held and portable electronic devices, as well as providing the technology used in intelligent control circuits in automotive and industrial applications. This broad spread of applications allows Dialog to derive value from a number of established as well as new and exciting high growth markets.

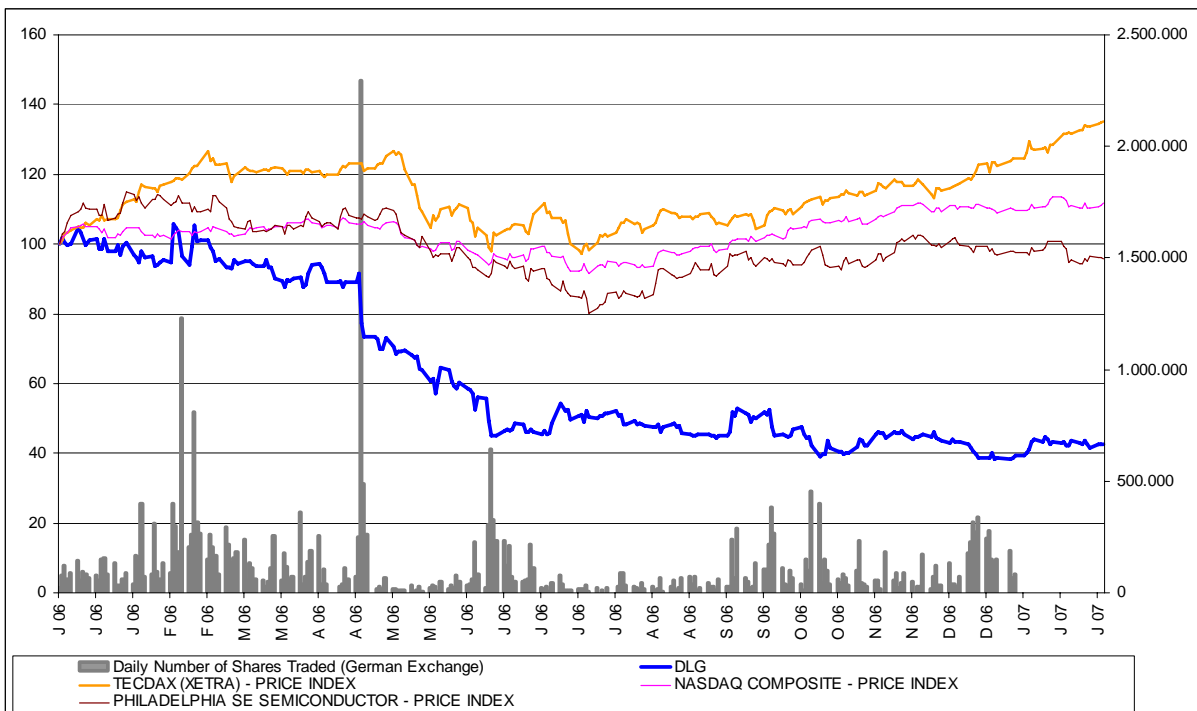
### The Dialog Semiconductor Share Price Development

During the last twelve months, as well as for the most part of the last three years, Dialog Semiconductor shares have underperformed against all relevant indexes. In Euro terms, the share price decreased by 58 percent from €2.69 at the beginning of the year to €1.14 at year-end. At the same time, the NASDAQ index declined by almost three percent in Euro terms. In contrast, the Philadelphia Semiconductor Index

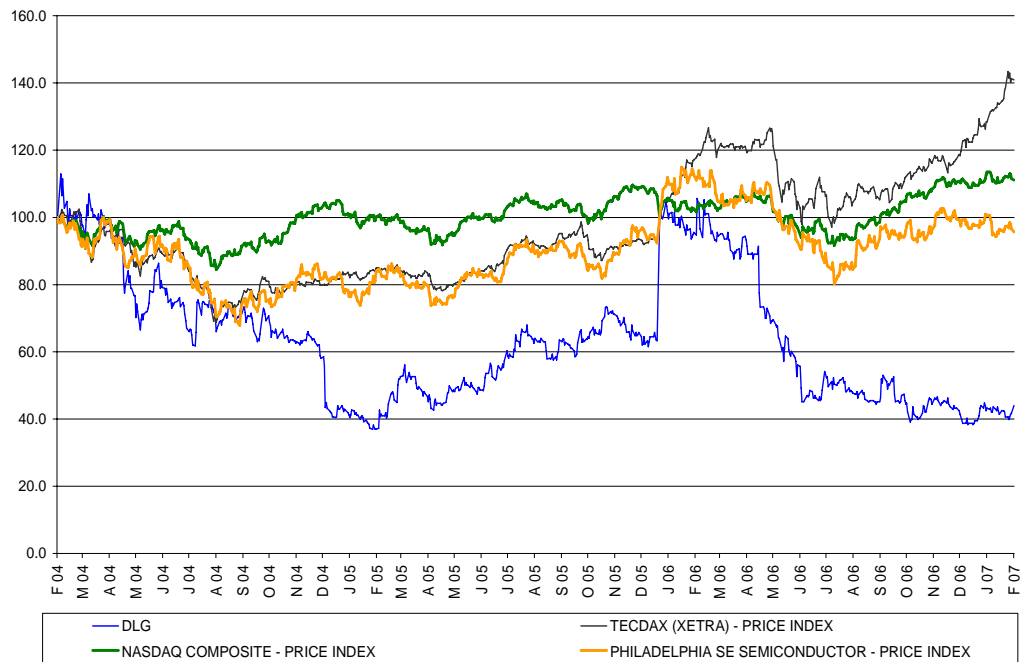
(SOX) rose by 10 percent and the German benchmark index TecDax increased by 25 percent, currency adjusted.

Over a three year time span, the Dialog Semiconductor share lost almost seventy percent of its value from €4.03 at the beginning of 2004 to €1.14 at the end of 2006. On the other hand, the German TecDax rose by 17 percent and the NASDAQ index gained 16 percent whilst US SOX in Euro terms lost 10 percent during the same time.

### 12 Month share price development relative to relevant benchmark indexes (in Euro terms)



### 3 Year share price development relative to relevant benchmark indexes (in Euro terms)



### Share Fundamentals for the Financial Year 2006

Share Fundamentals for the Financial Year 2006	
Total number of shares outstanding and registered as of December 31, 2006	46,068,930
Weighted average number of shares during 2006 (basic and diluted)	44,548,931
Type:	Ordinary
Par Value (in €):	0.10
Bloomberg Symbol:	DLG
Reuters Symbol:	DLGS.DE
ISIN:	GB0059822006
Key figures for the fiscal year 2006 based on weighted average number of shares (basic)	
Sales per share (from continuing operations in €):	1.60
Operating loss per share (from continuing operations in €):	(0.71)
Net loss per share (in €):	(0.75)
Book value per share as of December 31, 2006	1.20
Accounting standards:	IAS/IFRS
Market data 2006	
Exchange segment Germany:	Midcap, Prime All Share, Prime Technology, Technology All Share
Designated sponsor:	West LB
Market capitalization as of December 31, 2006 (in millions of €):	45
Turnover of shares during 2006:	74,263 shares / day

### Trading in Dialog shares

Dialog shares are traded in Germany on the XETRA and Frankfurt regulated official markets and on all other German regional exchanges on the open market.

The Company has made a strategic commitment to creating a lower cost platform in order to take full advantage of the key growth opportunities. In line with this commitment, the decision was taken in the fourth quarter of 2006 to terminate the company's American Depositary Receipt

programme (ADRs) and de-list from the NASDAQ National Market in the USA.

ADRs in Dialog Semiconductor were delisted from NASDAQ at the close of business on 28 December 2006. In accordance with SEC regulations governing de-registration from a US exchange, the company filed notice of its intention to de-register with the SEC (Form 15) on 31 January 2007, following which a 90 day period of due process is to be observed.

### Dividend policy

Dialog Semiconductor participates in industries that are considered to be global growth engines and provides its services and products to the major players in these industries.

Dialog's Board of Directors remains committed to re-investing all profits into laying this framework for future growth and continues to believe that – in line with the strategic changes underway – this policy is in the best interests of all Dialog shareholders.

### Investor Relations:

Dialog Semiconductor understands the importance of clear communication with both investors and analysts: especially during a period of strategic change. During 2006, the management team has continued its efforts to ensure that the market is kept up to date with the important and exciting changes underway at our company.

banks and research institutions in Europe. During 2006 we held our regular annual analyst conference and in addition kept in contact with our investors and our analysts.

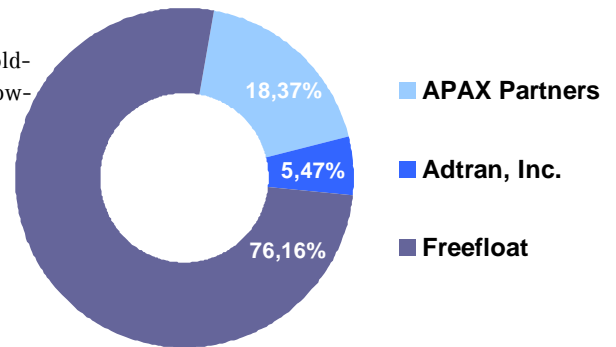
All information provided including presentations, press releases and reports of the company as well as the recommendations of analysts covering the company can be downloaded from the corporate website: [www.dialog-semiconductor.com](http://www.dialog-semiconductor.com).

The Dialog Semiconductor share is followed by a number of analysts representing major



### Shareholder Structure

Information regarding the main shareholders of the company is shown in the following graph.



### Freefloat

Freefloat includes 5,235,270 shares (11.4%) held by the Capital Group International, Inc. as notified on February 6, 2007 on

behalf of discretionary clients, and 1,178,957 shares (2.6%) held by the Dialog Semiconductor Plc Benefit Trust.

### Disclosure of Interests

The provisions of the UK Companies Act 2006 require that any person acquiring a direct or indirect interest of 3 percent or more of a class of shares issued by the company with voting rights at the company's general meetings must inform the

company of its interest within two working days. If the 3 percent interest is exceeded, the shareholder must inform the company of any increase or decrease of one percentage point in its interest.

# Corporate Profile

## Business Overview

Dialog Semiconductor develops and supplies a range of innovative integrated circuit (IC) solutions for wireless, automotive and industrial electronic systems. Our background and strengths are in designing low power mixed signal circuits for sensing, processing and conversion, high quality audio as well as expert handling of high voltages on CMOS technology. Our business model is a 'fabless' one whereby we design ICs, outsource production of silicon wafers, packaging, test and then deliver final chips to our customers.

Dialog's customers are designers and manufacturers of mobile handsets and portable electronic products, as well as industrial and automotive suppliers. Our system-on-chip solutions for their products range from comprehensive and highly integrated power management and audio ICs, to multimedia display driver ICs and intelligent automotive and industrial control products.

### History and Development of the Company

Our roots are firmly established in the design of complex analog and digital circuits. Dialog originated from the European activities of a US semiconductor company, International Microelectronic Products, Inc. ("IMP"), founded in 1981 in Silicon Valley, specializing in mixed signal CMOS semiconductor technology. After being acquired by Daimler-Benz AG and becoming a part of its subsidiary Temic Telefunken Microelectronic, Dialog Semiconductor Plc was created as a result of a subsequent management buy-out financed by Apax Partners, Adtran and Ericsson. Then in 1999 we made an initial public offering on the Frankfurt Stock Exchange and in 2000 listed on NASDAQ.

Throughout our history we have delivered several technology firsts. For example, in 1996 we introduced the first system level

CMOS power management device and four years later the first combined power management and audio device for 3G.

Innovative IC solutions for wireless, automotive and industrial electronics

### Global Presence

Our corporate headquarters are located near Stuttgart, Germany. We have product development facilities in Kirchheim, Heidelberg and Munich in Germany, Graz in Austria, Swindon and Edinburgh (since February 2006) in UK and Tokyo, Japan. To support our growing customer base we have expanded our sales offices to Japan, Taiwan, and the USA.

### Our Expertise

Dialog's competitive advantage comes from a strong track record in designing, manufacturing, testing and delivering mixed signal circuits produced entirely in complimentary metal oxide semiconductor ("CMOS") technology. Our core technological expertise is applied across different target markets, enabling maximum return on investment from our research and development while delivering the latest technology products for each of these chosen markets.

For example, the technology that helps us optimize power usage for mobile phones also provides us with the ability to deliver solutions in automotive and industrial applications.

### Our Employees

As at December 31, 2006 we had a global workforce of 234 employees, in eight locations worldwide, the majority of whom are employed in R&D functions.

## Our Mission and Strategy

Dialog's mission is:

"To be the leading global supplier of lowest power, highest quality mixed signal components and system level solutions to the wireless and automotive markets"

Achieving this mission requires a clearly focused strategy based on:

- Expanding relationships with key industry leaders
- Building on a common technology platform
- Designing, Manufacturing, Marketing and Supporting a wide range of customers with innovative Application Specific Standard Parts (ASSPs)
- Proactively refining customers' system architectures
- Expanding engineering expertise

- Selectively expanding global capabilities
- Remaining focused on our existing business model
- Delivering the highest quality products
- Becoming partner of choice for power management ICs for key 3G/HSDPA platform chipset providers

The success of this strategy has been demonstrated by the strong and growing relationships we have developed with some of our high profile, high volume customers. They see Dialog Semiconductor as a flexible partner and an integral part of their overall supply chain.

We work with our customers to rapidly develop appropriate responses, both technically and commercially, to changing market trends and requirements. Through our relationships with partners and manufacturers we then ensure rapid delivery of quality-approved products to the customer.

## Our Solution

Dialog's products address the needs of original equipment manufacturers (OEMs) requiring either ASSPs (Application Specific Standard Product) or custom ICs (ASICs). We design, develop and deliver mixed signal components and system level solutions based on our technological expertise in key areas such as power management, audio CODECS, and system-on-a-chip integration.

Our solutions address two major market segments:

- Mobile handset and portable electronic devices
- Automotive and industrial electronics

In mobile and portable applications, the key factor driving the pace of development of our product solutions is the rapid evolution of smaller and more sophisticated devices packed with advanced capabilities including high speed data, video and high quality audio.

This places substantial demands on our power management and audio solutions and requires excellent imaging and display technologies. Dialog's strength in developing highly integrated silicon solutions enables our customers to design their products to have market leading talk and standby times and deliver high performance audio playback. In addition, our display drivers are designed to support the ultra low power capabilities of emerging technologies and enhance the graphical user interface.

In the automotive and industrial segment, our products address the safety, management and control of electronic systems in the car and highly integrated smart power electronics management systems such as electronic ballasts for lighting.

In all our product areas, our customers acknowledge our leadership in creating innovative silicon system solutions in 100% CMOS technology - fully tested and delivered quickly to achieve competitive time-to-market objectives.

## Our Principal Products

Dialog's products utilize industry standard technology platforms to deliver unique, highly integrated and high performance capabilities for selected target application segments.

Our main product categories are:

- Power management and audio ICs
- Liquid crystal display drivers
- Application Specific ICs (ASICs)

### Power Management and audio ICs

The unrelenting drive towards smaller and more sophisticated portable consumer electronic products coupled with demands for longer battery life provide great challenges for designers and manufacturers of the silicon chips inside those products.

Effective power management is increasingly one of the most vital parts of system design - an area in which Dialog Semiconductor has considerable experience as a result of designing chips used in hundreds of millions of mobile phones and other portable consumer devices. Dialog Semiconductor offers customers a selection of power management and audio ASSPs including the new DA9030, DA9034 and DA9035 ICs which deliver a range of integrated features.

These ASSPs leverage our expertise in integrating both low and high voltage circuits on standard CMOS technologies, plus our experience in developing and integrating high performance audio CODEC functions. Combining these and other analog functions on to a single chip delivers

New power management ICs: DA9030, DA9034, DA9035

significant space, power and cost savings to our customers.

Our unique power management and audio solutions offer integration of over 30 different functions, in a single chip. Dialog delivers technologically advanced functions including:

- Smart Mirror™ LDO (low dropout voltage) regulators – offering very low current consumption, high power supply rejection performance and simplifying circuit design
- High efficiency buck and boost converters – designed for efficiencies over 90% with currents up to 500mA
- Programmable multiple chemistry battery chargers – handling all common battery technologies: NiMH, Li-Ion and polymer
- Audio subsystem including 24-bit DAC supporting 8 to 48 kHz sample rates, voice CODEC with programmable filtering and drivers for headphones and speakers. These are based on our own digital signal processing (DSP) design optimized for minimum power consumption and silicon area.

#### Display drivers and related system IC

In 2006 we launched the final range of color and monochrome STN (super-twisted nematic) liquid crystal display (LCD) drivers providing flexibility and reduced system cost for the consumer and mobile phone main and sub-display markets. Delivered as a standard part the DA8988 driver provides excellent resolution of up to 262,000 colors and addresses a demand for higher performance full color, high speed moving images using MLA (multi-line addressing) LCD technology.

The monochrome DA8109 has been targeted at the sub-display market. A key feature of this product is the side input which helps optimize the display size resulting in cost savings.

During 2006 we have also started to re-focus our strategic emphasis from the low margin commodity STN (super-twisted nematic) liquid crystal display (LCD) driver market towards value-added, system solu-

tions for emerging very low power display technologies.

Today's LCD displays consume in some applications up to 70% of the power which limits the ability of the display to be permanently on. To address this, a number of emerging very low power display technologies have been introduced to the market over the last few years.

One of these market leading technologies is the ultra low power Electronic Paper Display from E-ink. Dialog has formed a partnership with E-ink both on a marketing and also a technical level.

The relationship has resulted in Dialog developing a family of power efficient ASSP (application specific standard products) for a variety of applications in the portable consumer, mobile communication and industrial segments for Matrix, Flexible and segmented E-ink displays.

Last year we launched our first product which was designed into Lexar's USB Flash storage device. The display is designed to show available memory capacity even when there is no power applied. This function could not be performed with traditional LCD displays.

We will introduce over the coming months a family of Dialog chips to drive E-ink displays for a number of applications including mobile phones, flash storage products and E-books to name a few.

OLED's (organic light emitting diode) an emissive technology has started to gain commercial traction in the market place. The technology has a number of significant benefits over the traditional LCD products especially at video rates. The key benefits are low power and being emissive there is no requirement for power hungry back-lights.

Dialog has introduced its first product developed together with a leading Japanese OLED display supplier. A standard part DA8613 is a monochrome driver targeted at sub displays in mobile phones and portable consumer markets such as MP3 players. A

range of products to cover colour both for passive and active matrix panels is planned to be introduced in the future.

### Application Specific ICs (ASICs)

We are increasingly seeing standard product solutions addressing customer requirements in our target markets, though there is still a demand from some customers for custom solutions.

For selected high volume customers we offer application specific ICs (ASICs). These are designed using our expertise gained from many years of mixed signal development, integrating high voltage (up to 40V) with other circuits in proven mainstream CMOS technology, using the latest CAD tools. Dialog has an excellent track record of rapidly developing leading-edge ASICs to meet challenging customer time-to-market requirements.

For example, we have developed over 50 different power management designs for the world's leading mobile phone manufacturers. These ASICs offer unprecedented levels of integration with multiple power management functions on the chip – such as high performance LDOs (low drop out voltage regulators), high efficiency AC-DC converters, complete battery charging circuits, programmable LED drivers and USB interfaces, plus sophisticated audio capability

In automotive electronics, our ASICs control safety and comfort electronics for the top automobile manufacturers. This takes advantage of Dialog's competence in power management systems and mixed signal design, and its knowledge of integrating

high performance analog circuits and high-density digital logic and high voltage circuits on a single chip in a standard CMOS process. Our partnership with leading automotive equipment suppliers has also resulted in the development of chips able to be connected directly to the car battery without any external protection circuits. We currently address the following applications: Intelligent motor controllers for windscreen wiper systems, window lift and motorized seat belts.

In industrial systems, our single chip solutions integrate high voltage low power circuits for electronic ballasts used to control fluorescent lamps. Our customers are using ASICs that integrate, for example, the functionality of power factor correction circuits, lamp management circuits and half bridge drivers. Our expertise in the integration of these circuits forms the basis of highly integrated control chips for smart power electronic systems in other applications such as computer and mobile communications systems. Dialog's solution is ideal for situations where the chip must be both highly integrated and have the ability to control high voltages intelligently using digital circuits on the same chip.

Our ASIC solutions are manufactured by leading silicon foundries, with which we work in true partnership to ensure our customers can access both the latest CMOS processes and foundry capacity. This enables our customers to meet both costs and time-to-market objectives for their products. We also have our own process engineers in-house to ensure our customers benefit from the optimum capability of a process.

## Our Principal Customers

Our principal customers are recognized wireless communications, consumer electronics, and automotive equipment manufacturers. These include customers for both our standard products introduced over recent years and for application specific (ASIC) products.

The rapidly evolving technology in all our target market sectors means that a partnership approach with our customers is essential – whether for standard products or for custom solutions. Hence our customers look to Dialog as an outside source of expertise,

while the close working relationship provides us with an opportunity to continually develop and fine-tune market leading technological expertise with recognized industry leaders.

We have long-term relationships with customers such as Ericsson, Sony Ericsson Mobile Communications, Motorola, Siemens and Sharp for cellular phones; Adtran for wireline communications applications; Bosch and Conti Temic for automotive applications; and Tridonic for industrial applications.

## Our Product Cycle

As a fabless semiconductor manufacturer, our focus is on developing the products and technology and then delivering quality-approved products to our customers. Hence we design, develop and supply mixed signal ASICs and ASSPs, outsource the actual manufacture of wafers and assembly to selected foundries and assemblers, then test the products using in-house developed specialized test programmes, before final delivery to customers. The product cycle is as follows:

- Design and development
- Manufacture of wafers
- Assembly and testing
- Quality and environment control

### Design and development

Our customers gain significant advantage from our ability to rapidly develop mixed signal ASIC and ASSP designs, fostered through many years of design experience and a highly skilled engineering staff of over 100 professionals. Evolving designs are constantly monitored through our design library database and we achieve rapid design cycles through our strategy of modifying and reusing previously designed building blocks.

We use industry standard design tools from suppliers such as Cadence Design Systems,

Inc. to increase design automation and top-level simulation to identify system design incompatibilities at an early stage.

Our focus is on furthering our technological expertise in power management, audio-CODECs and display driver technology. We also ensure that our process teams are up to date with the latest commercially available CMOS manufacturing technologies.

Our total expenditure on research and development in 2006 was €20.9 million. This expenditure was focused on enhancing our leading edge analog design, DSP techniques, high voltage process R&D and CAD tools as well as test and verification systems.

### Manufacture of wafers

We outsource our wafer production to selected foundries with a demonstrated ability to provide high quality products on tight deadlines. Foundries we use include Chartered Semiconductor Manufacturing Pte., Ltd. in Singapore and Taiwan Semiconductors Manufacturing Co., Ltd. ("TSMC").

Our choice of technology is CMOS rather than bipolar, primarily because CMOS devices consume less power and permit more transistors to be integrated on a sin-

gle chip, which is essential for the target markets we address.

We aim to ensure that all steps in the manufacturing process can be provided by at least two suppliers, in order to prevent shortage or loss of chip production due to market conditions or disasters such as foundry fires.

Since the successful manufacture of silicon wafers is critical to our reputation and profitability, we work carefully to identify suitable foundries in order to maintain continuity and security of supply for our customers. We also place, where possible, our own process engineers directly at the foundry premises to resolve any potential engineering issues and to ensure both the quality and timely delivery of the finished product.

#### Assembly and testing

We outsource final assembly of the chips from the wafers to various sub-contractors in the Far East. Completely assembled chips will then undergo final testing before delivery to the customer.

Our rigorous testing approach allows us to ensure overall quality control of our manufactured products. The test programs developed by our test engineers are based upon specifications determined by individual customers as well as our own standard product specifications, and are developed in parallel with the design. Our test equipment is regularly calibrated to ensure the accuracy of test parameters.

As announced on September 18th 2006, we took the decision to transfer our Wafer test, Final test and Tape & Reel activity to dedicated outsourced assembly and test organizations in the Far East, confirming Dialog's true 'fabless' model. This transfer is expected to be completed by the second quarter of 2007.

#### Quality and environment control

Dialog Semiconductor's policy is to supply products and services in full compliance with relevant specifications to ensure customer requirements are met. Our quality management system has been established

and is maintained to provide customers with the assurance that our products and services fulfill both their contractual requirements as well as future needs. Our main target is to achieve 'Zero Fails'.

An uncompromising approach to quality assurance in every area of our operations, through active participation from every employee within the company, produces a highly structured quality environment that has resulted in Dialog Semiconductor being approved by all our major blue-chip customers.

In addition to ensuring the highest levels of product quality and operational efficiency, we also believe in a commitment to environmentally friendly products. Responsibility for nature and the environment have been an important part of our company philosophy and activities since 1999. Our aim is to minimize adverse environmental impact by advancing environmentally compatible product design and environmentally friendly activities.

As part of this commitment, we maintain a certified environmental management system in accordance with international standards (ISO14001). Awareness and knowledge of environmental issues is promoted throughout the organization so that it becomes a natural part of the decision making process.

As a fabless semiconductor company, Dialog Semiconductor's business model is based on strategic outsourcing. In order to achieve the highest quality we must demand world-class quality standards from our fabrication, assembly and test partners as well as our own internal processes to increase our customers' confidence in our products. Dialog Semiconductor is accredited to QS9000/ISO9001:2000/ISO14001 and as an extension of this practice it is our policy to build partnerships with suppliers who are also qualified to the same international quality standards.



# Management Report

*The following discussion of our financial condition and results of operations should be read in conjunction with the audited financial statements included in*

*this annual report, which have been prepared in accordance with International Financial Reporting Standards (IFRS).*

## Executive Summary

More than 650 million of Power Management ICs shipped

New products reduce dependency on few customers

Operating profit is a key performance indicator

We are a global supplier of power management, audio and display driver technology, delivering innovative mixed signal standard products as well as application specific integrated circuits for wireless, automotive and industrial applications. To date, we have shipped over 650 million integrated circuits for mobile phones. We operate in intense competitive markets and our customers select us based upon numerous factors including price, design cycle time, reliability and performance. Our customers purchase our products through periodic orders made throughout the year. The prices paid for each type of product or designs are generally agreed with customers for specified periods and/or volumes. Potential price reductions in subsequent periods are typically offset with lower production costs as a result of improved yields, lower wafer costs or smaller chip sizes.

Critical success factors for us include the continued growth in the worldwide market for cellular handsets, the completion of our new designs on a timely basis, customer acceptance and implementation of our designs in large-scale production and continued demand from our key customers for the development of new products. Partnerships with companies at all levels of business are important for our success in a market dominated by major international semiconductor companies. We rely on our 'fabless' business model that enables us to focus on our research and development activities, which are essential for us to respond to our customers' cutting edge silicon solutions requirements and also to maintain our competitiveness in our market. Consequently, it is critical for us to make significant and ongoing cash expen-

ditures to fund our research and development activities. We have also made significant investments in long-lived assets, primarily for our in-house test equipment.

We have significant liquid assets on hand, primarily from the remaining sales proceeds from the issuance of our ordinary shares in 1999 and 2000, from cash generated from operations in previous years and from recoveries of certain of our investments and deposits. Substantially all of our near term future cash inflows are expected to come from the sale of our products. We continue to improve the management of our inventory, reducing our days of inventory from 73 days in 2005 to 64 days in the fourth quarter of 2006. We generally collect cash from our customers within 55 days after product delivery (at 31 days in the fourth quarter of 2006). However, we derive a substantial portion of our revenues from a relatively small number of wireless communications manufacturers. Sales to five customers accounted for 75% of total revenues in 2006. This compares to 64% of total revenues over three customers in 2005. We continue to develop new products for new customers to further minimize the risk of this dependency. Such new products include new intelligent motion control ICs in the automotive market. We anticipate material opportunities in the future to include growth in our main market, cellular handsets, based on the expected transition to 3G, and further worldwide growth in semiconductor sales, especially in Asia. However, our revenues, profitability and growth could decline if the growth in these markets slows. We believe that our key performance indicators driving our operating profit or loss are revenues, gross margin and research and develop-

ment costs. Accordingly, our Board of Directors and management use operating

profit as a measure of performance.

## Operating and Financial Review

### Forward-looking statements.

*This annual report contains "forward-looking statements". All statements regarding our future financial condition, results of operations and businesses, strategy, plans and objectives are forward-looking. Statements containing the words "believes", "intends", "expects" and words of similar meaning are also forward-looking. Such statements involve unknown risks, uncertainties and other factors that may cause our results, performance or achievements or conditions in the markets in which we operate to differ from those expressed or implied in such statements. These factors include, among others, product demand, the effect of economic conditions and conditions in the semiconductor and telecommunications markets, exchange rate and interest rate movements, capital and credit market developments, the timing of customer orders and manufacturing lead*

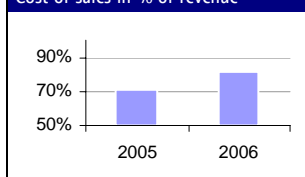
*times, the changes in customer order and payment patterns, the financial condition and strategic plans of our major customers, insufficient, excess or obsolete inventory, the impact of competing products and their pricing, product development, commercialization and technological difficulties, political risks in the countries in which we operate and sale and supply constraints. It is not possible to predict or identify all such factors. Consequently, any such list should not be considered to be a complete statement of all potential risks or uncertainties. We do not assume any obligation to update forward-looking statements.*

*The following table sets forth historical consolidated statements of operations of Dialog for the fiscal years ended December 31, 2006 and 2005 in thousands of Euros and as a percentage of revenues:*

(in thousands of €)	2006		2005		Change
	€	% of revenues	€	% of revenues	%
Revenues					
Wireless	43,953	61.7	103,359	79.9	(57.5)
Automotive / Industrial	27,315	38.3	26,047	20.1	4.9
<b>Revenues</b>	<b>71,268</b>	<b>100.0</b>	<b>129,406</b>	<b>100.0</b>	<b>(44.9)</b>
Cost of sales	(57,989)	(81.4)	(92,529)	(71.5)	(37.3)
<b>Gross profit</b>	<b>13,279</b>	<b>18.6</b>	<b>36,877</b>	<b>28.5</b>	<b>(64.0)</b>
Selling and marketing expenses	(5,455)	(7.7)	(7,205)	(5.5)	(24.3)
General and administrative expenses	(13,386)	(18.8)	(6,349)	(4.9)	110.8
Research and development expenses	(20,885)	(29.3)	(20,624)	(15.9)	1.3
Restructuring and related impairment charges	(4,639)	(6.5)	-	0.0	-
<b>Operating profit (loss)</b>	<b>(31,086)</b>	<b>(43.6)</b>	<b>2,699</b>	<b>2.1</b>	<b>(1,251.8)</b>
Interest income, net	874	1.2	723	0.6	20.9
Foreign currency exchange gains and losses, net	(1,581)	(2.2)	1,018	0.9	(255.3)
Other income	-	0.0	28	0.1	(100.0)
<b>Result before income taxes</b>	<b>(31,793)</b>	<b>(44.6)</b>	<b>4,468</b>	<b>3.5</b>	<b>(811.6)</b>
Income tax expense	120	0.3	(15,296)	(11.9)	0.0
<b>Net loss from continuing operations</b>	<b>(31,673)</b>	<b>(44.4)</b>	<b>(10,828)</b>	<b>(8.4)</b>	<b>192.5</b>
<b>Loss from discontinued operations</b>	<b>(1,720)</b>	<b>(2.4)</b>	<b>(12,517)</b>	<b>(9.7)</b>	<b>(86.3)</b>
<b>Net loss</b>	<b>(33,393)</b>	<b>(46.9)</b>	<b>(23,345)</b>	<b>(18.0)</b>	<b>43.0</b>

## Results of Operations

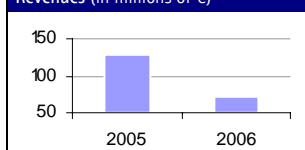
Cost of sales in % of revenue



### Segment Reporting

Revenues in the wireless communications sector were €44.0 million for the year ended December 31, 2006 compared with €103.4 million for the year ended December 31, 2005, comprising 61.7% and 79.9% of our total revenues from continuing operations for those periods. The decrease in this sector resulted from lower sales volumes as certain of our products are phasing out following the transition from 2G handsets to 3G, and successor products will only go into production during 2007. The loss of 2G revenue was accelerated by the unforeseen insolvency of BenQ Mobile GmbH at the end of the third quarter of 2006. In addition, increased competitive pressures for display driver chips, particularly at the commodity end of the market forced us to exit those non profitable product lines in keeping with our strategy to improve our margins. The operating loss in this sector was €23.6 compared to an operating profit of €4.5 million in 2005.

Revenues (in millions of €)

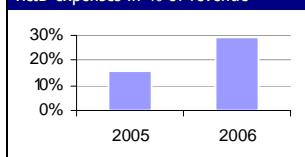


Revenues from our automotive / industrial applications sector were €27.30 million and €26.0 million for the years ended December 31, 2006 and 2005, respectively, representing 38.3% and 20.1% of our total revenues from continuing operations for those periods. Operating loss in the sector was €0.7 million in 2006, compared to an operating profit of €1.1 million in the previous year. The reason for the decrease in operating profits was mainly due to inventory write downs.

### Revenues

Revenues were €71.3 million for the year ended December 31, 2006 compared with €129.4 million for the year ended December 31, 2005. The decline of 44.9% in revenues results from lower sales volumes, primarily in the wireless communications sectors as described above.

R&D expenses in % of revenue



### Cost of Sales

Cost of sales consists of the costs of outsourcing production and assembly, related personnel costs and applicable overhead and depreciation of test and other equipment. Cost of sales decreased by 37.3% from €92.5 million (71.5% of our total revenues) for the year ended December 31, 2005 to €58.0 million (81.4% of our total revenues) for the year ended December 31, 2006, in line with reduced production volumes. In addition, as a result of lower production volume, our internal testing operation has been running at a reduced utilization level, which in turn has increased our cost of sales in 2006.

### Selling and Marketing Expenses

Selling and marketing expenses consist primarily of salaries, travel expenses, sales commissions and costs associated with advertising and other marketing activities. Selling and marketing expenses decreased from €7.2 million or 5.5% of total revenues for the year ended December 31, 2005, to €5.5 million or 7.7% of total revenues for the year ended December 31, 2006, in line with lower sales volumes.

### General and Administrative Expenses

General and administrative expenses consist primarily of personnel and support costs for our finance, human resources, information systems and other management departments. General and administrative expenses increased from €6.3 million in 2005 to €13.4 million in 2006 respectively. The increase of 110.8% primarily results from the costs incurred as a write-down of accounts receivable of €2.0 million and inventory and materials at suppliers of €4.4 million dedicated to BenQ Mobile GmbH which went into insolvency in 2006.

### Research and Development Expenses

Research and development expenses consist principally of design and engineering related costs associated with the development of new application specific integrated circuits ("ASICs") and application specific standard products ("ASSPs"). Research and development expenses remained relatively

stable and were €20.9 million in 2006 and €20.6 million in 2005. As a percentage of total revenues research and development expenses increased from 15.9% to 29.3% over those periods, resulting from a lower revenue base in 2006.

### Restructuring and related impairment charges

In the third quarter of 2006 we decided to transfer the companies 'Wafer Test', 'Final Test' and 'Tape & Reel' divisions to dedicated outsourced assembly and test organizations in Asia. This transfer is planned to be executed in three phases between October 2006 and the second quarter of 2007. Restructuring and related impairment charges are mainly comprised of €1.2 million of employee termination costs that will be paid to 33 employees affected by the transfer and €3.1 million of asset impairment charges.

Furthermore, in the fourth quarter of 2006, we booked a €119 thousand restructuring charge to cover severance compensation as a result of reducing the size of our US sales force.

For further information see note 3 to the interim consolidated financial statements.

### Operating Profit (Loss)

We reported an operating loss of €31.1 million for 2006 and an operating profit of €2.7 million for 2005. This decline in operating income was primarily due to lower gross profits recognized in 2006, the write-down of BenQ Mobile GmbH receivables, inventory and materials at suppliers and the restructuring charges as described above.

### Interest Income, net

Interest and similar income, net from the Company's investments (primarily short-term deposits and securities) was €0.9 million for the year ended December 31, 2006 and €0.7 million for the year ended December 31, 2005, reflecting mainly higher cash equivalents and marketable securities balances during 2006.

### Foreign Currency Exchange Gains and Losses, net

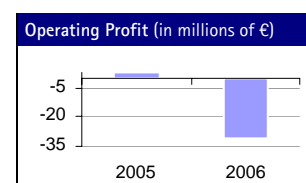
Foreign currency transaction gains and losses result from amounts ultimately realized upon settlement of foreign currency transactions and from the period end re-measurement of foreign currency denominated receivables and payables into Euros. Foreign currency exchange losses, net were €1.6 million for the year ended December 31, 2006 compared to foreign currency gains, net of €1.0 million for the year ended December 31, 2005. These foreign exchange gains and losses primarily result from the fluctuation of the Euro against the US Dollar. In 2006 the US Dollar fell in value against the Euro whereas in 2005 the US Dollar gained in value against the Euro.

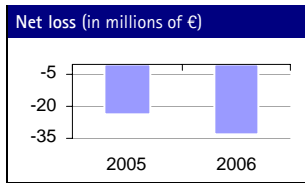
### Income Tax benefit (expense)

Income tax benefit was €216 thousand in 2006 compared to an income tax expense of €15,896 thousand in the year ended December 31, 2005. The benefit in 2006 mainly relates to a refund of a corporation tax credit in Germany, which we were able to recognize after a change in tax legislation in late 2006. The income tax expense in 2005 mainly reflects a valuation allowance on deferred tax assets of €15.3 million primarily related to the uncertainty about our ability to realise our German tax-loss carry forwards.

### Loss from discontinued operations

The losses from discontinued operations were €1.7 million and €12.5 million in the years ended December 31, 2006 and 2005, respectively. The losses in both periods consist of the operating losses of our previous Imaging division which we disposed of in February 2006 as well as legal and transaction fees related to the disposal of the Imaging division in the three months ended March 31, 2006. The loss in 2005 resulted primarily from a write-down of certain assets attributable to the Imaging business. For further information please see note 4 to the consolidated financial statements.





### Net Loss

For the reasons described above, we reported a net loss of €33.4 million and €23.3 million for the years ended December 31, 2006 and 2005 respectively. Loss per share (basic) was €0.75 in 2006 and €0.53 in 2005.

## Trend Information

### General

The semiconductor industry in general is highly cyclical and has been subject to significant economic downturns which, at various times, have resulted in production overcapacity, reduced product demand and an accelerated erosion of average selling prices.

Revenues from our wireless communications applications accounted for 62% of our total revenues for the year ended December 31, 2006, 80% of our total revenues for the year ended December 31, 2005, 78% of our total revenues for the year ended December 31, 2004 and 75% of our total revenues for the year ended December 31, 2003.

### Market Trends

During 2006, we have seen a significant increase in the number of applications requiring more sophisticated power management technology (GPS, personal media players, DSC, Games and infotainment). This trend is fueled by explosive growth in 3G/HSDPA technology and wireless broadband, a growing demand for innovative 'always-on' displays for cell phones requiring very low to zero power, a continued demand for in-car electronics and new intelligent motor controllers all over the car. We are also seeing the burgeoning of a demand for telematics products. The key headline trends that are particularly relevant to Dialog's business are indicated in the following section.

### Cellular handsets

Total cellular handset shipments exceeded 1,019 million in 2006, representing a significant 25% growth over 2005 (In-Stat/Strategy Analytics Nov 2006/Jan 2007). We continue to see the consolidation of market position among the top five handset manufacturers, which through

economies of scale and global reach have squeezed out second tier players – in 2006, manufacturers outside the top five lost 21% of their previous market share. This trend is likely to continue as the leading players will be best positioned to capture the ultra low cost and the high performance 3G market spaces.

While new cellular subscriber additions are relatively static in most developed markets, subscribers trading up to more advanced phones, or replacement phones, are continuing to increase and account for up to 30 percent of the market.

In 2006, 3G cellular systems became firmly established, taking a substantial share of the replacement market in Europe, with one of the key drivers for growth being the introduction by manufacturers of new 3G phone models in form factors comparable to their 2.5G counterparts. Dialog Semiconductor's solutions address the WCDMA sector of 3G, and worldwide WCDMA shipments grew significantly in 2006 (In-Stat, October 2006). As network operators increase promotional activity to boost the market and new applications such as mobile TV spur further demand, this rapid growth trend is expected to continue for the next several years.

### Convergence devices

Personal media players and personal navigation devices are just two examples of products that have seen significant growth in 2005/6.

Music players started off as devices playing MP3 and other encoded audio formats but quickly transformed into personal media players and now start to be integrated into cell phones. This market has grown spectacularly in the past two years and is fore-

Sales of mobile devices in 2006 exceeded all expectations and closed at 1,019 million units up 25% compared to 2005

cast to continue with CAGR of 30.2% for the next five years (InStat, June 05). These applications require both audio and power management and LCD driver solutions with both cost and performance being key metrics.

Personal navigation devices are effectively single application PDAs (personal digital assistants). Whilst the traditional PDA market has stagnated at around 15 million units per year, new applications such as the navigation device are expected to double in growth in coming years. Built around a powerful applications processor, these devices require audio and power management functionality similar to that seen in high-end smart phones.

#### Automotive

The demand for in-car electronics continued to be strong during 2006, especially as more and more vehicles provide as part of the standard accessories or options package many of the features once found in only top-of-the-range cars. In particular, Dialog Semiconductor's products enable intelligent motor controllers found all over the car – such as in windscreen wipers, seat controls and window controls.

#### Geographic Market Trends

We allocate our revenues to countries based on the location of the shipment destination. Changes in revenues from period to period have differed among geographical regions. Our customers continue to increase their production in the greater China region and to add new Asian customers. In Germany, revenue decreased by 47% from €25.4 million for the year ended December 31, 2005 to €9.2 million for the year ended December 31, 2006, due primarily to the insolvency of BenQ Mobile GmbH.

#### Revenue Trends

Management is confident that 2007 will amount to a year of growth for the Company. A similar set of market conditions to those experienced in the fourth quarter of 2006 are expected to prevail in the first half of 2007. However, with the expected commencement in the third quarter of 2007 of volume production in Dialog's new 3G offering, the Company anticipates growth

in the second half of 2007. This increase is expected to be broadened by a number of products targeting high growth opportunities in mobile phone, consumer, automotive and industrial markets and supported by a strengthened and diversified customer base. Our forward visibility with respect to customer demand is limited and a successful introduction of new products depends on the completion of new designs on a timely basis. Our revenues for 2007 will also be highly dependent on continued growth in the worldwide market for cellular handsets.

#### Gross Margin Trends

Our gross margin decreased from 28.5% of revenues for the year ended December 31, 2006 to 18.6% of revenues for the year ended December 31, 2006, primarily resulting from lower utilization of our internal test operations and lower margins of certain display driver products. We expect in the near term gross margin percentage to improve over 2006 as we complete the transfer of our test operation from Germany to offshore and start benefiting from a richer product mix.

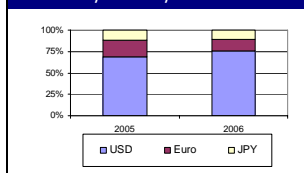
#### Research and Development Expenditure Trends

Research and development expenditure amounted to €20.9 million in 2006 and €20.6 million in 2005. We expect research and development costs to increase slightly in 2007 as we are planning to add to our headcount in order to strengthen our core competence. Our ability to generate revenues in the long term depends on achieving technical feasibility from our research and development programs, and on customers accepting our designs and implementing them in large-scale production.

#### Foreign Currency Exchange Rate Trends

The reporting currency for our consolidated financial statements is the Euro. The functional currency for our operations is generally the applicable local currency. Accordingly, the assets and liabilities, the equity accounts and the statements of income and cash flow of companies whose functional currency is not the Euro must be translated into the reporting currency (the Euro). See note 2 to the consolidated financial statements for further information. Changes in

Revenue by currency

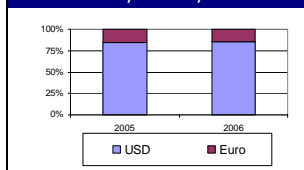


exchange rates also influence the results of our operations. Our sales are primarily denominated in US Dollars and Euro, whereas our purchases of raw materials and manufacturing services are primarily denominated in US Dollars.

In order to hedge our foreign currency exposure, primarily to the US Dollar, we attempt to match cash inflows and outflows in the same currency.

From the beginning of the year through to December 31, 2006, the Euro appreciated approximately 11.5% against the US Dollar.

Cost of sales by currency



Changes in the exchange rate between the Euro and other non-Euro currencies, principally the US Dollar, will affect the translation of our consolidated financial results into Euro, and will also affect the value of any amounts that our subsidiaries distribute to us. Exchange rate changes may also affect our balance sheet. Changes in the Euro values of our assets and liabilities resulting from exchange rate movements may cause us to record foreign currency gains and losses. Dialog Semiconductor PLC does not currently use foreign exchange instruments to hedge its currency risk. We ensure that the net exposure is kept to an acceptable level by selling or buying foreign currencies (primarily GBP and EUR) spot when needed.

For the year ended December 31, 2006, 76% of our revenues were denominated in US Dollars, 13% were denominated in Euro and 11% were denominated in Japanese Yen, and 85% of our material costs were denominated in US Dollars and 15% were denominated in Euro. For the year ended December 31, 2005, 69% of our revenues were denominated in US Dollars, 19% were denominated in Euro and 12% were denominated in Japanese Yen, and 84% of our material costs were denominated in US Dollars and 16% were denominated in Euro.

We also have foreign currency risks with respect to our net investments in foreign subsidiaries in Japan, the United Kingdom and the United States. Foreign currency translation gains and losses with respect to these subsidiaries are included in other comprehensive income.

With the announcement we made in late September 2006 to transfer our Wafer Test, Final Test and Tape & Reel activity from Nabern Germany to the Far East, we now expect that by the end of the second quarter of 2007 all our manufacturing cost will be USD denominated. This triggering event is now effectively making Dialog a USD functional company.

As a result, the Company announced on 28 February 2007 that it will change the group functional and reporting currency from EURO to USD effective January 1, 2007.

## Liquidity and Capital Resources

### Cash flows

Cash provided by operating activities was €12.3 million and €10.3 million for the years ended December 31, 2006 and December 31, 2005 respectively. The cash inflow in 2006 primarily resulted from the collection of trade accounts receivable and lower inventory balances. The cash inflow in 2005 primarily resulted from lower inventory balances.

Cash used for investing activities was €5.0 million for the year ended December 31, 2006 compared with cash used for investing activities of €7.5 million for the year ended December 31, 2005. Cash used for investing activities for the year ended December 31, 2006 consisted mostly of the purchase of test equipment, tooling (masks), laboratory equipment, probe cards and load boards for a total of €2.8 million, the investment in Dialog Imaging Systems of

€1.2 million and the purchase of software and licenses of €1.1 million. Cash used for investing activities for the year ended December 31, 2005 consisted mostly of the purchase of software and licenses of €5.5 million and the purchase of test equipment, tooling (masks), laboratory equipment, probe cards and load boards for a total of €4.0 million, the cash outflow in 2005 was partly offset by the sale of marketable securities of €2.0 million.

### Liquidity

At December 31, 2006 we had €24.3 million in cash and cash equivalents (€16.9 million in 2005) and €14.7 million in marketable securities (€14.9 million in 2005). The working capital was €41.3 million compared to €64.8 million in 2005.

As of December 31, 2006 we had no long-term debt. A decrease in customer demand for our products caused by unfavorable industry conditions or an inability to develop new products in response to technological changes could materially reduce the amount of cash generated from operations.

If necessary, we have available for use short-term credit facilities of €12.5 million that bear interest at a rate of EURIBOR +

0.75% per annum. At December 31, 2006 we had no amounts outstanding under these facilities. Accordingly, we believe the funding available from these and other sources will be sufficient to satisfy our working capital requirements in the near to medium term.

### Capital Expenditures and Investments

Purchases of property, plant and equipment were €2.8 million for the year ended December 31, 2006 compared to €4.0 million for the year ended December 31, 2005. Our capital expenditures in 2006 and 2005 consisted primarily of purchasing new or replacement test systems, tooling equipment, handling systems and other equipment in the ordinary course of our business. Purchases of intangible assets were €0.4 million in 2006 and €8.8 million in 2005. Capital expenditures in 2005 were higher than in 2006 as in 2005 we acquired licensing contracts for the use of electronic design automated tools in the total amount of €7.8 million. See note 12 to the consolidated financial statements.

In future periods, we may make strategic investments or acquisitions in connection with our plans to expand our business internationally.

### Balance Sheet

(in thousands of €)	2006	2005	Change	%
<b>ASSETS</b>				
Cash and cash equivalents and securities	38,983	31,810	7,173	22.5
All other current assets	11,726	47,281	(35,555)	(75.2)
<b>Total current assets</b>	<b>50,709</b>	<b>79,091</b>	<b>(28,382)</b>	<b>(35.9)</b>
Property, plant and equipment, net	9,420	15,710	(6,290)	(40.0)
Intangible assets	1,198	7,175	(5,977)	(83.3)
All other non current assets	1,740	1,162	578	49.7
<b>Total non current assets</b>	<b>12,358</b>	<b>24,047</b>	<b>(11,689)</b>	<b>(48.6)</b>
<b>TOTAL ASSETS</b>	<b>63,067</b>	<b>103,138</b>	<b>(40,071)</b>	<b>(38.9)</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
Current liabilities	9,453	14,308	(4,855)	(33.9)
Non-current liabilities	-	2,932	(2,932)	(100.0)
Net Shareholders' equity	53,614	85,898	(32,284)	(37.6)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>63,067</b>	<b>103,138</b>	<b>(40,071)</b>	<b>(38.9)</b>



Balance sheet total was €63.1 million and €103.1 million as of December 31, 2006 and December 31, 2005, respectively. Current assets decreased from €79.1 million as of December 31, 2005 to €50.7 million as of December 31, 2006. In line with decreased sales volumes as well as certain write-downs in the course of the year, trade accounts receivable and inventory went down, leading to a decline of current assets of €36.3 million compared to last year. Long-term assets decreased from €24.0 million, or 23.3% of the balance sheet total, as of December 31, 2005 to €12.4 million, or 19.6% of the balance sheet total, as of December 31, 2006. The decrease mainly results from the depreciation and amortization of property, plant and equipment and intangible assets of €8.3 million, the cancellation of capitalized software contracts with a remaining book value of €3.3 million (for further information see note 12 to the consolidated financial statements), the asset write-down related to the restructuring of €3.1 million and the reclassification of certain non-current assets of €1.1 million into "assets held for sale" which are classified as current assets. For further information see note 4 to the consolidated financial statements.

This was partially offset by capital expenditures and investments in 2006 of €5.0 million.

Current liabilities in 2006 were €4.9 million below the previous year's level. This relates mainly to lower trade accounts payables in the course of our reduced business volume. We have no non-current liabilities at December 31, 2006. The non-current liabilities of €2.9 million at December 31, 2005 consisted exclusively of the financing equivalent related to capitalized software contracts which were cancelled in 2006. See

note 12 to the consolidated financial statements.

Shareholders' equity decreased from €85.9 million at December 31, 2005 to €53.6 million at December 31, 2006 due to the net loss in 2006. The very solid equity ratio increased slightly to 84.9% from 83.3%.

#### Off-Balance Sheet Arrangements and Other Commitments

We have no off-balance sheet arrangements involving variable interest entities. We lease all of our office facilities, office equipment and vehicles under operating leases. In addition we have contracted consulting services related to CAD (computer aided designs) until December 29, 2009. Future minimum payments under these agreements, which have initial or remaining terms in excess of one year at December 31, 2006, are as follows:

(in thousands of €)	Operating leases
within 1 year	5,327
between 1 and 2 years	4,642
between 2 and 3 years	3,146
between 3 and 4 years	209
between 4 and 5 years	158
Thereafter	0
<b>Total</b>	<b>13,481</b>

We have no long-term debt, capital lease obligations, unconditional purchase obligations or any other long-term obligations that would have a material impact on our liquidity or financial condition. We have supply agreements with various suppliers

#### Dividends

We did not pay dividends in the years ended December 31, 2006 and 2005. We do not plan to pay dividends in the foreseeable future.

## Risk Factors

The market in which we compete is characterized by continuous development and technological improvement. As a result, our success depends on our ability to develop new designs and products on a cost effective, timely basis. Our future success also depends on our ability to anticipate and respond to new market trends, to rapidly implement new designs which satisfy customers' desire and to keep abreast of technological changes within the semiconductor industry generally. It is not possible to predict or identify all relevant risk factors and, therefore, the following list should not be considered to be a complete statement of all potential risks or uncertainties.

- We have not been profitable for the last six fiscal years, and there is no guarantee that we will return to profitability
- We currently depend on a few customers for a substantial portion of our revenues, and the loss of one or more of these customers may result in a material decline in our revenues
- Our revenues, profitability and growth could decline if the growth of the wireless communications market slows
- If we are unable to adapt rapidly to changing markets and technology, we may lose customers and be unable to develop new business
- The semiconductor industry is highly cyclical in nature and this results in periodic overcapacity
- We face intense competition, and if we are unable to compete effectively or if we are unable to adapt rapidly to changing markets and technology, we could lose customers and be unable to develop new business
- The loss of one of our principal foundry relationships or assembly and test services or a delay in foundry or assembly production may result in a material loss of production and revenues
- Obtaining access to manufacturing capacity at semiconductor manufacturing plants may become increasingly difficult and could result in higher costs and a material loss of revenues
- Perceived health risks relating to cellular handsets could lead to decreased demand for our products
- Our business, financial condition and reputation may be materially adversely affected if our products, or the electronic systems of which they are a part, contain defects that cause damage or injury
- Our products are difficult to manufacture and manufacturing defects can adversely affect our results
- We may not be able to remain competitive if we lose any of our key executives or if we cannot hire and retain qualified engineers and sales and marketing personnel
- If we are unable to protect our intellectual property and know-how from being copied or used by others, our competitors may gain access to its content and technology
- The profitability of our business may be adversely affected by currency fluctuations and by the economic and legal developments in the countries where we conduct our business
- We may become a passive foreign investment company
- US-resident shareholders may find it more difficult to protect their interests than they would as shareholders of a US-based corporation
- Our future operating results could be materially affected if judgments underlying any of our accounting policies were to significantly change

## Outlook

### Wireless

With an estimated one billion cell phone devices shipped in the year 2006, the cellular industry will maintain its rapid transition towards deployment of UMTS based technologies for the rest of this decade. This technology and the provision of higher speed data transfer by use of HSDPA/HSUPA provides further momentum in the delivery and use of multimedia services and wireless broadband to consumers.

Services such as digital TV, MP3, video and games on a mobile handheld platform in turn will fuel the requirement for advanced silicon components for managing the battery energy, better quality audio signal processing and higher quality and power-efficient display systems.

In addition to the 3G driven growth, there is a growing demand for the use of cell phones from a number of emerging economies such as India and China that will maintain the growth potential of this industry for a number of years to come.

Dialog Semiconductor has developed a portfolio of products that take advantage of these trends. With highly integrated audio and power management circuits developed with lead partners in 3G chipset and application processors, Dialog will be able to grow its business, by benefiting from the transition to 3G as well as expansion of higher functionality smart phone segments.

Our co-operation with emerging low power and ultra thin display partners will also place us in a key position to capitalize on the upcoming changes in handheld display technologies that enable further functionality for mobile devices such as higher resolution video display, 'fuel gauges', TV and news service, as well as longer battery life.

Personal media players, navigation devices, digital still cameras and PDAs will also continue to generate demand for greater portability and longer battery life.

### Automotive

The Automotive sector has been receiving further attention from the market analysts in the past year and is seen as a new growth market for increasing semiconductor content in the future. These applications include safety, comfort and increasingly entertainment and navigation services.

Dialog has entered 2007 with a growing business focused on developing highly integrated intelligent controllers for small motors in the car cabin that enhance passenger comfort and safety. There are more than 50 motors deployed in a typical mid size car for applications such as windscreen wipers, car seat movements, safety belts, electric windows, air conditioning amongst others. In addition our core competencies in the power and audio processing will become increasingly relevant in taking advantages of opportunities in emerging "info-tainment" markets.

## Directors' Report

The directors of Dialog Semiconductor Plc ("Dialog" or the "Company") are pleased to present their annual report to shareholders, together with the IFRS compliant financial statements for the year ended December 31, 2006. These accounts have been prepared for UK statutory reporting purposes. Separate accounts to comply with the rules governing the Company's German listing are available from the company's website.

### Principal activities and results

Details are set out in the Corporate Profile and Management Report sections of the Annual Report

### Annual General Meeting

The notice convening the 2007 Annual General Meeting of the Company will be published separately and posted on the Company's website. The Annual General Meeting will be held at Tower Bridge House, St Katharine's Way, London E1W 1AA on Thursday 10 May, 2007 at 9:00 am.

### Share capital

Details of the Company's share capital are set out in note 15 to Consolidated Financial Statements.

### Substantial shareholding

Details are set out the Shareholder Information section of Dialog Semiconductor PLC Annual Report.

### Directors

Details are set out in the Corporate Governance section.

### Directors' remuneration and interests

Statements of directors' remuneration and their interests in the shares of the Company as at December 31, 2006 are set out in note 21 to the Consolidated Financial Statements. No company in the Group was, during or at the end of the financial year, party to any contract of significance in which any director was materially interested.

### Corporate governance

The Company's corporate governance statement is set out in the next section of Dialog Semiconductor PLC Annual Report.

### Supplier payment policy

It is the Group's policy to pay creditors when they fall due for payment. Days payable outstanding for the Group at year end was 43 days (2005: 30 days).

### Research and development

The Group believes that its future competitive position will depend on its ability to respond to the rapidly changing

needs of its customers in the wireless communications and automotive sectors by developing new designs in a timely and cost effective manner. To this end, management of the Company is committed to research and development expenditures by employing design and engineering staff primarily for the development of new products and further customisation of existing products. To date, research and development projects have been in response to requests from key customers to assist in the development of their new products and for the development of application specific standard products ("ASSPs"). The Company does not expect any material change to this approach in the foreseeable future.

### Proposed dividend

The directors do not recommend the payment of a dividend in 2006 (2005: nil).

### Purchase of own shares

The Company operates an Employee Share Option Trust. The Trust purchases shares in the Company for the benefit of employees under the Company's share option scheme. Since the Company has de facto control of the assets and liabilities of the Trust, they are included within the Company and Group balance sheets. At December 31, 2006, the Trust held 1,178,957 shares which represent 2.6% of the total called up share capital, and a nominal value of £ 117,896.

### Political and charitable contributions

The group made no political or charitable contributions during the period.

### People within the company

Our policy is to support our people by training, career development and opportunities for promotion. We believe in an open management approach and close consultation on matters of concern to our staff. Information is shared on the Company's performance which, together with performance related bonuses, encourages staff involvement. The Company's policy provides that disabled persons, whether registered or not, shall be considered for employment, training and career development having regard to their aptitude and abilities.

### Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the directors' report are listed in note 21 to the Consolidated Financial Statements. Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

#### Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of Ernst & Young LLP as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

#### By order of the board

Dr. Jalal Bagherli  
Director  
April 10, 2007

Registered Office:  
  
Tower Bridge House  
St Katharine's Way  
London E1W 1AA

## Directors' Remuneration Report

*The following information has not been audited*

### Policy on Directors' Remuneration

The board is responsible for setting the Company's policy on directors' remuneration and the Compensation Committee decides on the remuneration of each executive director.

The primary objectives of the Company's policy on executive directors' remuneration are first, that it should be structured so as to attract and retain executives of a high calibre with the skills and experience necessary to develop the Company successfully and, secondly, to reward them in a way which encourages the creation of value for the shareholders.

The performance measurement of the executive director and the determination of his annual remuneration package is undertaken by the Compensation Committee.

No director is involved in determining or deciding his or her own remuneration. The Compensation Committee consists exclusively of non-executive directors and its role is, inter alia, to apply the board's policy on remuneration. The current members of this committee are Messrs. McMonigall (chairman of the Compensation Committee), Glover and Reyes.

The Company has one Director, Dr. Jalal Bagherli who was appointed on September 12, 2005. Up to February 14, 2006 Mr. Roland Pudelko was an executive director of the company.

The executive director's remuneration consists of three components:

**1. Salary** - Reflects the executive's experience, responsibility and market value.

**2. Bonus** - As part of his remuneration Dr. Jalal Bagherli received a supplementary bonus. The supplementary bonus is due on a quarterly basis until December 31, 2007 and relates to benefits associated with an early exit from his previous employment contract. Since 1 January 2006 further bonuses are based on objectives set by the Compensation Committee relative to the performance of the Group, as an incentive to the executive director to achieve relevant and demanding targets

**3. Share options** - Details are set out in note 17 to the Consolidated Financial Statements.

### Compensation of non-executive directors

Non-executive directors who are not associated with any of our principal shareholders are paid quarterly for their role as directors. Additional payments are made for participation in the Company's board committees, the Audit Committee, the Compensation Committee and the Nomination Committee.

All of our directors are reimbursed for their reasonable travel expenses incurred in connection with attending meetings of the board or committees thereof. Under certain circumstances, directors are also eligible to receive share options.

Further information concerning the remuneration of directors is set out in the Notes to the Consolidated Financial Statements, note 21.

### Directors' contracts

The service agreement, dated July 19, 2005 with the executive director, Dr. Jalal Bagherli, is of unlimited duration. The agreement is terminable by either party on 6 months' notice.

### Performance graph

Details are set out in the Shareholder Information section of the Group's Annual Report.

### Share options

Details are set out in notes 17 and 21 to the Consolidated Financial Statements.

### Directors' share interests

Directors' beneficial interests (as defined by the Companies Act 1985) in 10p ordinary shares of the Company are set out in notes 17 c) and 21 to the Consolidated Financial Statements..

### Directors' pension arrangements

The Company contributes 9% of the executive director's basic salary to a pension scheme. There are no pension promises or similar arrangements for non-executive directors.

*The following information has been audited*

The compensation of the members of the board of directors is as follows:

Name	Position	Base salary	Compensation (in €)				Directors holdings	
			Buy out	Other	2006 Total	2005 Total	Shares	Options 3)
Tim Anderson	Non-executive Director until February 1, 2006 - now Company Secretary	-	-	-	-	7,312	75,166	-
Dr. Jalal Bagherli 1)	Executive Director and CEO since September 12, 2005	238,308	201,743	35,121	475,172	145,921	324,900	451,888
Chris Burke	Non-executive Director since July 13, 2006	14,894	-	-	14,894	-	-	50,000
Michael Glover	Non-executive Director	35,001	-	-	35,001	57,400	195,000	50,000
Aidan Hughes	Non-executive Director and Chairman of the Audit Committee	44,683	-	-	44,683	71,658	25,000	50,000
John McMonigall	Non-executive Director	31,278	-	-	31,278	30,711	-	50,000
Roland Pudelko 2)	Executive Director, CEO and President until September 12, 2005, non-executive Director until February 14, 2006	281,250	-	-	281,250	322,100	-	-
Gregorio Reyes	Non-executive Chairman since July 13, 2006	42,821	-	-	42,821	43,872	60,000	50,000
Michael Risman	Non-executive Director until July 13, 2006	18,618	-	-	18,618	36,560	1,172	-
Russ Shaw	Non-executive Director since July 13, 2006	14,894	-	-	14,894	-	-	50,000
Peter Tan	Non-executive Director since July 13, 2006	14,894	-	-	14,894	-	-	50,000
Jan Tufvesson	Non-executive Chairman until July 13, 2006	26,065	-	-	26,065	78,970	175,062	-
Peter Weber	Non-executive Director since February 1, 2006	31,650	-	-	31,650	-	25,000	50,000
		<b>794,356</b>	<b>201,743</b>	<b>35,121</b>	<b>1,031,220</b>	<b>794,504</b>	<b>881,300</b>	<b>851,888</b>

1) The amount shown under "buy out" relates to a payment in connection with a buy out provision for Dr. Bagherli's previous employment. Of the amount shown under "other" €14,400 relates to pension contributions under a defined pension contribution plan

2) The base salary in 2006 is composed of post employment benefits

3) For further information see note 17 to the consolidated financial statements.

### Non-Executive Directors' terms

All non-executives Directors are appointed for up to 3 years term by the Board of Directors, subject to any earlier requirements to stand for re-election as required by the Articles of Associations (one third of the non-executive directors must stand for re-election at each annual AGM meeting).

This applies regardless of any terms prescribed in their director's contracts.

### Share options granted to the executive Director

As of December 31, 2006, the executive director, Jalal Bagherli, held 451,888 options over ordinary shares which entitle him to acquire 451,888 shares:

Exercise Price	Date of Grant	Expiry date	Vesting period	At December 31, 2005	Number of options			At December 31, 2006
					granted	exercised	cancelled	
€ 0.00	12.09.2005	11.09.2015	181 days	150,000	-	(150,000)	-	-
€ 2.00	12.09.2005	11.09.2015	4 years	60,000	-	-	-	60,000
€ 3.50	12.09.2005	11.09.2015	4 years	60,000	-	-	-	60,000
€ 5.00	12.09.2005	11.09.2015	4 years	60,000	-	-	-	60,000
€ 6.50	12.09.2005	11.09.2015	4 years	60,000	-	-	-	60,000
€ 8.00	12.09.2005	11.09.2015	4 years	60,000	-	-	-	60,000
€ 0.10	01.02.2006	18.07.2015	1 - 44 months	-	100,000	-	(5,937)	94,063
€ 0.10	01.02.2006	18.07.2015	1 - 44 months	-	61,475	-	(3,650)	57,825
				450,000	161,475	(150,000)	(9,587)	451,888

25 percent of the shares granted with a 4 year vesting period may be exercised on September 30, 2006, 2007, 2008 and 2009. There is no performance criteria linked to the exercise of these options.

The shares granted in February 2006 are subject to the achievement of performance and market targets to vest in eight equal semi-annual tranches between March 31, 2006 and September 30, 2009.

On March 14, 2006 Jalal Bagherli exercised 150,000 shares; the market value at the date of exercise was €2.53.

#### Share options granted to the non-executive Directors

At the 2006 Annual Shareholders Meeting, shareholders approved a stock option plan for non-executive directors. Each non-executive Director is entitled to an initial grant of 50,000 options vesting monthly in equal tranches over 48 months and each year thereafter, as soon as possible after the Annual Shareholder Meeting a further 20,000 options vesting over 12 months. Options are exercisable at the market price prevailing at the date of grant. The non-executive directors are not subject to performance criteria when it comes to remuneration. This applies to board membership fees, attendance fees and stock option grants. Therefore the stock options granted to non-executive directors are not subject to the achievement of performance targets.

The share option grants to non-executive Directors are as follows:

Director	Exercise Price	Date of Grant	Expiry date	Vesting period	At December 31, 2005	granted	cancelled	At December 31, 2006
Tim Anderson	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	(50,000)	-
Chris Burke	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Michael Glover	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Aidan Hughes	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
John McMonigall	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Gregorio Reyes	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Michael Risman	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	(50,000)	-
Russ Shaw	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Peter Tan	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
Jan Tufvesson	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	(50,000)	-
Peter Weber	€ 1.40	12.07.2006	11.07.2013	48 months	-	50,000	-	50,000
					-	550,000	(150,000)	400,000

Approved by the board of directors and signed on its behalf by

Tim Anderson  
Secretary  
April 10, 2007



## Statement of directors' responsibilities

The directors are responsible for preparing the IFRS Report and Accounts 2006 and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements on the same basis.

The group and parent company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the group and the parent company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;

- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Director's Report and Director's Remuneration Report that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Independent Auditors' Report

## Independent auditor's report to the members of the Board of Directors of Dialog Semiconductor Plc:

We have audited the group and parent company financial statements (the "financial statements") of Dialog Semiconductor Plc for the year ended 31 December 2006 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statement of Changes in Equity and the related notes 1 to 28. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory

requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial information, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. The information given in the director's report includes that specific information presented in the Operating and Financial review that is cross referred from the Business Review section of the director's report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions are not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Operating and Financial Review and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examina-

tion, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

**Opinion**

In our opinion:

- the group financial statements give a true and fair view, in accordance with

IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2006 and of its loss for the year then ended;

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the financial statements.

Ernst & Young LLP  
Registered auditor  
Reading  
April 10, 2007

# Consolidated Financial Statements

## Dialog Semiconductor Plc

### Consolidated Income Statement

(in thousands, except per share data)	Notes	2006		
		(unaudited) 1)	2006	2005
		\$	€	€
Revenues	19	94,052	71,268	129,406
Cost of sales		(76,528)	(57,989)	(92,529)
<b>Gross profit</b>		<b>17,524</b>	<b>13,279</b>	<b>36,877</b>
Selling and marketing expenses		(7,199)	(5,455)	(7,205)
General and administrative expenses		(17,666)	(13,386)	(6,349)
Research and development expenses	19	(27,562)	(20,885)	(20,624)
Restructuring and related impairment charges	4	(6,122)	(4,639)	-
<b>Operating profit (loss)</b>	<b>19</b>	<b>(41,025)</b>	<b>(31,086)</b>	<b>2,699</b>
Interest income		1,358	1,029	852
Interest expense		(205)	(155)	(129)
Foreign currency exchange gains and losses, net		(2,086)	(1,581)	1,018
Other income		-	-	28
<b>Result before income taxes</b>		<b>(41,958)</b>	<b>(31,793)</b>	<b>4,468</b>
Income tax benefit (expense)	6	158	120	(15,296)
<b>Net loss from continuing operations</b>		<b>(41,800)</b>	<b>(31,673)</b>	<b>(10,828)</b>
<b>Loss from discontinued operations</b>	<b>3</b>	<b>(2,270)</b>	<b>(1,720)</b>	<b>(12,517)</b>
<b>Net loss</b>		<b>(44,070)</b>	<b>(33,393)</b>	<b>(23,345)</b>
<b>Loss per share</b>				
Basic and diluted		(0.99)	(0.75)	(0.53)
<b>Net loss per share from continuing operations</b>				
Basic and diluted		(0.94)	(0.71)	(0.25)
<b>Weighted average number of shares (in thousands)</b>				
Basic and diluted	2	44,549	44,549	44,173

1) Amounts for the year 2006 are also presented in U.S. Dollars ("\$"), this information is un-audited and presented solely for convenience of the reader at the rate of €1 = \$1.3197, the Noon Buying Rate of the Federal Reserve Bank of New York on December 30, 2006.

## Dialog Semiconductor Plc

### Consolidated Balance Sheet

	Notes	At December 31, 2006 (unaudited) 1)	At December 31, 2006	At December 31, 2005
(in thousands)		\$	€	€
<b>ASSETS</b>				
Cash and cash equivalents		32,071	24,302	16,920
Available-for-sale financial assets	7	19,375	14,681	14,890
Trade accounts receivable, net	8	4,672	3,540	28,364
Inventories	9	7,468	5,659	17,155
Prepaid expenses	10	491	372	505
Other current assets		1,449	1,098	1,257
		<b>65,526</b>	<b>49,652</b>	<b>79,091</b>
Non current assets classified as held for sale	4	1,395	1,057	-
<b>Total current assets</b>		<b>66,921</b>	<b>50,709</b>	<b>79,091</b>
Property, plant and equipment, net	11	12,432	9,420	15,710
Intangible assets	12	1,581	1,198	7,175
Investments	3	1,622	1,229	-
Deposits		231	175	205
Assets for current tax	6	443	336	-
Prepaid expenses	10	-	-	957
<b>Total non-current assets</b>		<b>16,309</b>	<b>12,358</b>	<b>24,047</b>
<b>TOTAL ASSETS</b>		<b>83,230</b>	<b>63,067</b>	<b>103,138</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
Trade accounts payable		6,032	4,571	8,987
Provisions	13	1,432	1,085	194
Income taxes payable		28	21	24
Other current liabilities	14	4,983	3,776	5,103
<b>Total current liabilities</b>		<b>12,475</b>	<b>9,453</b>	<b>14,308</b>
<b>Total non-current liabilities</b>		<b>-</b>	<b>-</b>	<b>2,932</b>
Ordinary Shares		9,275	7,028	7,028
Share premium		222,988	168,969	168,832
Accumulated deficit		(159,863)	(121,136)	(88,621)
Other reserves		(1,413)	(1,071)	(1,090)
Employee stock purchase plan shares		(232)	(176)	(251)
<b>Net Shareholders' equity</b>	15	<b>70,755</b>	<b>53,614</b>	<b>85,898</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>83,230</b>	<b>63,067</b>	<b>103,138</b>

1) Amounts for the year 2006 are also presented in U.S. Dollars ("\$"), this information is unaudited and presented solely for convenience of the reader at the rate of €1 = \$1.3197, the Noon Buying Rate of the Federal Reserve Bank of New York on December 30, 2006.

## Dialog Semiconductor Plc

### Consolidated Statements of Cash Flows

(in thousands)	2006 (unaudited) 1)	2006	2005
	\$	€	€
<b>Cash flows from operating activities:</b>			
Net income (loss)	(44,069)	(33,393)	(23,345)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Recovery of investment	-	-	(28)
Restructuring and related impairment charges	5,479	4,152	-
Write-down of inventories 2)	7,909	5,993	6,576
Write-down of trade accounts receivable	2,647	2,006	-
Expense related to stock compensation	1,159	878	1,052
Depreciation of property, plant and equipment	7,096	5,377	7,619
Impairment of imaging assets	-	-	3,917
Amortization of intangible assets	3,888	2,946	2,807
Impairment of deferred tax asset	-	-	15,282
Losses on disposals of fixed assets	1,474	1,117	42
Interest income, net	(1,153)	(874)	(723)
Other income tax expense	(158)	(120)	14
<b>Changes in working capital:</b>			
Trade accounts receivable	30,079	22,792	(4,307)
Inventories	7,262	5,503	6,063
Prepaid expenses	154	117	235
Trade accounts payable	(5,821)	(4,411)	(6,406)
Provisions	(176)	(133)	24
Other assets and liabilities	(875)	(663)	1,025
<b>Cash generated from operations</b>	<b>14,895</b>	<b>11,287</b>	<b>9,847</b>
Interest paid	(8)	(6)	(1)
Interest received	1,412	1,070	481
Income taxes paid	(49)	(37)	(28)
<b>Cash provided by operating activities</b>	<b>16,250</b>	<b>12,314</b>	<b>10,299</b>
<b>Cash flows from investing activities:</b>			
Recovery of investment	-	-	28
Purchases of property, plant and equipment	(3,737)	(2,832)	(4,036)
Purchases of intangible assets	(1,334)	(1,011)	(5,528)
Investments and deposits made	(1,566)	(1,187)	(7)
Sale of available-for-sale financial assets	-	-	2,009
<b>Cash used for investing activities</b>	<b>(6,637)</b>	<b>(5,030)</b>	<b>(7,534)</b>
<b>Cash flows from financing activities:</b>			
Sale of employee stock purchase plan shares	280	212	96
<b>Cash provided by financing activities</b>	<b>280</b>	<b>212</b>	<b>96</b>
<b>Cash provided by operating, investing and financing activities</b>	<b>9,893</b>	<b>7,496</b>	<b>2,861</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(151)	(114)	82
<b>Net increase in cash and cash equivalents</b>	<b>9,742</b>	<b>7,382</b>	<b>2,943</b>
Cash and cash equivalents at beginning of period	22,329	16,920	13,977
Cash and cash equivalents at end of period	32,071	24,302	16,920

1) Amounts for the year 2006 are also presented in U.S. Dollars (“\$”), this information is unaudited and presented solely for convenience of the reader at the rate of €1 = \$1.3197, the Noon Buying Rate of the Federal Reserve Bank of New York on December 30, 2006.

2) In 2005 the write down of inventories was shown in the line “inventories”.

## Consolidated Statements of Changes in Shareholders' Equity

(in thousands of €)	Ordinary Shares	Additional paid-in capital	Accumulated deficit	Other reserves			Total
				Currency translation adjustment	Available for sale securities	Employee stock purchase plan shares	
<b>Balance at December 31, 2004</b>	<b>7,028</b>	<b>168,782</b>	<b>(66,328)</b>	<b>(930)</b>	<b>(28)</b>	<b>(297)</b>	<b>108,227</b>
Net loss	-	-	(23,345)	-	-	-	(23,345)
Other comprehensive income (loss)	-	-	-	139	(271)	-	(132)
Total comprehensive loss							(23,477)
Sale of employee stock purchase plan shares	-	50	-	-	-	46	96
Equity settled transactions, net of tax	-	-	1,052	-	-	-	1,052
<b>Balance at December 31, 2005</b>	<b>7,028</b>	<b>168,832</b>	<b>(88,621)</b>	<b>(791)</b>	<b>(299)</b>	<b>(251)</b>	<b>85,898</b>
Net loss	-	-	(33,393)	-	-	-	(33,393)
Other comprehensive income (loss)	-	-	-	40	(21)	-	19
Total comprehensive loss							(33,374)
Sale of employee stock purchase plan shares	-	137	-	-	-	75	212
Equity settled transactions, net of tax	-	-	878	-	-	-	878
<b>Balance at December 31, 2006</b>	<b>7,028</b>	<b>168,969</b>	<b>(121,136)</b>	<b>(751)</b>	<b>(320)</b>	<b>(176)</b>	<b>53,614</b>

# Notes to the Consolidated Financial Statements

## 1. General

### a) Company name and registered office

Dialog Semiconductor Plc  
Tower Bridge House  
St Katharine's Way  
London E1W 1AA  
United Kingdom

### b) Description of Business

Dialog Semiconductor Plc and subsidiaries ("Dialog" or the "Company") is a fabless semiconductor company that develops and supplies power management, audio and display driver technology, delivering innovative mixed signal standard products as well as application specific IC solutions for wireless, automotive and industrial applications. The Company's expertise in mixed signal design, with products manufactured entirely in CMOS technology, enhances the performance and features of wireless, hand-held and portable electronic products. Its technology is also used in intelligent control circuits in automotive and industrial applications. Production of these designs is then outsourced, and the final tested products delivered to the customers. As announced on September 18<sup>th</sup> 2006, we took the decision to transfer our Wafer test, Final test and Tape & Reel activity to dedicated outsourced assembly and test organizations in the Far East, confirming Dialog's true 'fabless' model. We expect this transfer to be completed by second quarter of 2007.

### c) Vulnerability Due to Certain Significant Concentrations

The Company's future results of operations involve a number of risks and uncertainties. Factors that could affect the Company's future operating results and cause actual results to vary materially from historical results include, but are not limited to, the highly cyclical nature of both the semiconductor and wireless communications industries, dependence on certain customers and the ability to obtain adequate supply of sub-micron wafers.

The Company's products are generally utilized in the cellular communications and automotive industries. The Company generates a substantial portion of its revenue from the wireless communications market, which accounted for 62% and 80% of the Company's total revenue for the years ended December 31, 2006 and 2005, respectively.

The Company's revenue base is diversified by geographic region and by individual customer. Changes in foreign currency exchange rates influence the Company's results of operations. The Company's sales are primarily denominated

in US dollars and Euros whereas purchases of raw materials and manufacturing services are primarily denominated in US dollars. The Company also has foreign currency exchange risks with respect to its net investments in foreign subsidiaries in Japan, the United Kingdom and the United States. Fluctuations in these currencies could significantly impact the Company's reported results from operations.

The Company depends on a relatively small number of customers for a substantial portion of its revenues, and the loss of one or more of these customers may result in a significant decline in future revenue. During 2006 four customers individually accounted for more than 10% of the Company's revenues. Total revenues from these four customers were €48,558 thousand or 68%. Net receivables from these four customers were €4,348 thousand at December 31, 2006. During 2005 three customers individually accounted for more than 10% of the Company's revenues. Total revenues from these three customers were €82,996 thousand or 64%. Net receivables from these three customers were €23,908 thousand at December 31, 2005. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers.

### d) Basis of Presentation

The accompanying consolidated financial statements have been prepared on the basis of the recognition and measurement requirements of IFRS and its interpretation adopted by the EU. Based on these standards, management has applied the accounting policies as set out below.

Although Dialog Semiconductor Plc is a UK company, its principal operations are located in Germany and all of its operating subsidiaries are held by the German subsidiary. Accordingly, the financial statements are presented in thousands of Euro ("€").

The financial statements are prepared on the historical cost basis except that financial instruments classified as available-for-sale are stated at their fair value.

### Reclassification

Certain prior year balances have been reclassified to confirm with the current year presentation. In order to improve the



financial statements presentation certain provisions have been reclassified to other current liabilities (2006: €3,396 thousand , 2005: €3,378 thousand)

The consolidated financial statements for the year ended December 31, 2006 were authorized for issue in accordance with a resolution of the directors on 10 April 2007.

A summary of significant accounting policies is provided in note 2.

## 2. Summary of Significant Accounting Policies

### Principles of Consolidation and Investments in Affiliated Companies

The consolidated financial statements include Dialog Semiconductor Plc and all of its owned subsidiaries as at December 31 each year:

Name	Registered office	Participation
Dialog Semiconductor GmbH	Kirchheim/Teck - Nabern, Germany	100%
Dialog Semiconductor (UK) Limited	Swindon, UK	100%
Dialog Semiconductor Inc	Wilmington, Delaware, USA	100%
Dialog Semiconductor KK	Tokyo, Japan	100%

The financial statements are prepared for the same reporting year as the parent company, using consistent accounting policies.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which Dialog Semiconductor Plc obtains control, and continue to be consolidated until the date such control ceases.

All inter-company accounts and transactions are eliminated in consolidation.

### Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturity dates of three months or less.

### Available-for-sale financial assets (Marketable Securities)

Available-for sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or as a financial asset at fair value based on the most recent quoted market price of each security through profit or loss. Marketable securities at December 31, 2006 and 2005, respectively consist of exchange traded funds accounted for on the basis of the settlement date.

The classification of financial assets is determined after initial recognition and, where allowed and appropriate, the company re-evaluates this designation at each financial year end. All regular purchases and sales of financial assets are recognized on the trade date, which is the date that the purchase of assets is committed.

After initial measurement, unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a component of other reserves until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. Any impairment losses on avail-

able-for-sale security are charged to earnings. If this impairment relates to losses previously recognized in equity then the impairment loss is transferred from equity to the income statement. Interest income is recognized when earned. The fair value of the available-for sale financial assets that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date.

### Inventories

Inventories include assets held for sale in the ordinary course of business (finished goods), in the process of production (work in process) or in the form of materials to be consumed in the production process (raw materials). Inventories are valued at the lower of cost or market value. Cost, which includes direct materials, labor and overhead plus indirect overhead, is determined using the first-in, first-out (FIFO) method. Work in process for customer specific development projects is classified as inventory.

### Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. All trade accounts receivable are from customers. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company has a process of continual review of its allowance for doubtful accounts. Management considers the col-

lectibility of a trade account receivable to be impaired when it is probable that the Company will be unable to collect all amounts due according to the sales terms based on current information and events regarding the customers' ability to repay their obligations. When a trade receivable is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows. Any credit losses are included in the allowance for doubtful accounts through a charge to bad debt expense. Account balances are set off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. In the profit and loss account, impairment losses are generally included in sales and marketing expenses. Extraordinary impairment losses are shown under general expenses. Recoveries of trade receivables previously written-off are recorded when received. Reversals of impairment losses, if any, would be included in other operating income. The Company does not have any off balance sheet credit exposure related to its customers.

#### Non-current assets held for sale

Assets that meet the criteria of IFRS 5 are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continuing use. The assets are available for immediate sale and the sale is highly probable. The assets have been accounted for at the lower of the carrying amount or each asset's estimated fair value less costs to sell.

#### Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of the plant and equipment when that cost is incurred, if the recognition criteria are met. Depreciation is charged on a straight-line basis over the estimated useful lives of the assets as follows:

Equipment	Useful life
Test equipment	3 to 8 years
Leasehold improvements	Shorter of useful life or lease term
Office and other equipment	3 to 13 years

The asset's residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end.

#### Intangible Assets

Purchased intangible assets with estimable useful lives primarily consist of licenses, software and patents and are recorded at acquisition cost less accumulated amortization. Intangible assets are amortized on a straight-line basis over the estimated useful lives of 3 to 5 years. For a particular software license a useful life of 10 years was estimated. Amortization expenses are allocated to the cost of goods sold,

selling expenses, research and development expenses or general administration expenses. The company has no intangible assets with an indefinite useful life.

#### Liabilities

Trade accounts payable and other current liabilities are recognized at payment or redemption amounts.

#### Impairment of Long-Lived Assets

In accordance with IAS 36, at each reporting date an assessment whether there is an indication that a long-lived asset, such as property, plant and equipment or purchased intangibles may be impaired is made. If any such indication exists, or when annual impairment testing for an asset is required, an estimation of the asset's recoverable amount is made. An asset's recoverable amount is the higher of an asset's fair value less cost to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining the fair value less costs to sell, an appropriate valuation model is used.

For assets, an assessment is made at each reporting date as to whether any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, an estimation of the recoverable amount is made. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized.

#### Foreign Currencies

The functional currency for the Company's operations is generally the applicable local currency. Accordingly, the assets and liabilities of companies whose functional currency is other than the Euro are included in the consolidation by translating the assets and liabilities into the reporting currency (the Euro) at the exchange rates applicable at the end of the reporting year. Equity accounts are measured at historical rates. The statements of income and cash flows are translated at the average exchange rates during the year. Translation gains or losses are accumulated as a separate component of shareholders' equity. Foreign currency transaction gains and losses are included in financial income, net at each reporting period. They result from amounts ultimately realized upon settlement of foreign currency transactions and from the period end re-measurement of foreign currency denominated monetary assets and liabilities into the functional currency of the respective entity.

The exchange rate of the more important currencies against the Euro used in preparation of the consolidated financial statements was as follows:

Currency	Exchange rate at		Annual average exchange rate	
	Dec 31, 2006	Dec 31, 2005	2006	2005
	€ 1 =	€ 1 =	€ 1 =	€ 1 =
Great Britain	0.67	0.69	0.68	0.68
Japan	156.65	139.13	146.02	136.88
United States	1.32	1.18	1.26	1.24

### Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- There is a change in contractual terms, other than a renewal or extension of the arrangement.
- A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term.
- There is a change in the determination of whether fulfilment is dependant on a specified asset.
- There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b).

For arrangements entered into prior to 1 January 2005, the date of inception is deemed to be 1 January 2005 in accordance with the transitional requirements of IFRIC 4.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

### Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and other sales taxes or duty. The following specific recognition criteria must also be met before revenue is recognized:

### Sale of Goods

Revenue from the sale of goods is derived from the sale of its products, applications specific integrated circuit ("ASIC") and application specific standard product ("ASSP") to end customers. These products are manufactured and tested in accordance with the customer's technical specifications prior to delivery. Revenue is recognized when title passes, the risks and rewards of ownership have been transferred to the customer, the fee is fixed or determinable, and collection of the related receivable is probable. Revenues are recorded net of sales taxes and customer discounts, if any.

The Company has insurance for product claims and also records a provision for warranty costs as a charge in cost of sales, based on historical trends of warranty costs incurred as a percentage of sales, which management has determined to be a reasonable estimate of the probable costs to be incurred for warranty claims in a period. Returns are permitted only for quality-related reasons within the applicable warranty period and any potential warranty claims are subject to the Company's determination that it is at fault for damages, and usually such claims must be submitted within a short period following the date of sale.

### Research and Development

Revenue from customer specific research and development contracts involving the development of new customer specific technology is recognized on the percentage of completion basis when the outcome of the contract can be estimated reliably. A contract's outcome can be estimated reliably when total contract revenue can be estimated reliably, it is probable that economic benefits associated with the contract will flow to the company, and the stage of contract completion can be measured reliably. When we are not able to meet those conditions, the policy is to recognize revenues only equal to costs incurred to date, to the extent that such costs are expected to be recovered. Completion is measured by reference to costs incurred to date as a percentage of estimated total project costs. The percentage of completion method relies on estimates of total expected contract revenue and costs, as well as the dependable measurement of the progress made towards completing the particular project.

Losses on projects in progress are recognized in the period they become likely and estimable.

#### *Interest Income*

Revenue is recognized as interest accrues.

#### **Product-Related Expenses**

Cost of sales consists of the costs of outsourcing production and assembly and test, personnel costs and applicable overhead and depreciation of equipment. Provisions for estimated product warranty are recorded in cost of sales at the time the related sale is recognized.

Expenses for customer specific research and development contracts in progress are recognized based on their percentage of completion. Internal research and development expenses are not allocated on a contractual basis. A division of research and development costs is stated in note 19 – segment reporting.

#### **Selling and Marketing Expenses**

Selling and marketing expenses consist primarily of salaries, travel expenses, sales commissions, bad debt expenses and costs associated with advertising and other marketing activities.

#### **General and Administrative Expenses**

General and administrative expenses consist primarily of personnel and support costs for finance, human resources, information systems and other management departments which are not attributable to development, production or sales functions. In 2006, the write-down of accounts receivable and inventories related to the insolvency of BenQ Mobile GmbH (“BenQ”) was also recorded in general and administrative expenses.

#### **Research and development costs**

Costs identified as research costs are expensed as incurred, whereas development costs are capitalized as an intangible asset and amortized if the Company can demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits. Among other things, the Company can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if

it is to be used internally, the usefulness of the intangible asset;

- the availability of adequate technical, financial and other resources to complete the development and use or sell the intangible asset; and
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

As not all of these conditions were satisfied, especially the generation of probable future benefit, development costs have not been capitalized as an intangible asset.

#### **Income Taxes**

Current income taxes for current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using tax rates that have been enacted or substantially enacted by the balance sheet date expected to apply to taxable income in the years, in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. A deferred tax asset is recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

#### **Stock-Based Compensation**

The Company has established an equity-settled share option scheme under which employees and directors may be granted stock options to acquire shares of the company.

The fair value of options granted is recognized as a compensation expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the service period during which the employees become unconditionally entitled to the options.

The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the best estimate of the number of equity instruments that will ultimately vest. The income statement charge or credit for a period represents the movement in cumulative expense recognized as at the beginning of the period.

The fair value of the options granted is measured using the Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. Expectations of early exercise are accounted for within the average life of the options. The Company applies IFRS 2 to all options granted after November 7, 2002 that had not yet vested as of January 1, 2005.

### Loss per Share

Loss per share has been computed using the weighted average number of outstanding ordinary shares for each year. Because the Company reported a net loss in each of the two periods presented, only basic per share amounts have been presented for those periods. Had the Company reported net income in 2006 and 2005, the weighted average number of shares outstanding would have potentially been as follows:

(in thousands)	2006	2005
Basic number of shares	44,549	44,173
Effect of dilutive options outstanding	1,512	1,010
Dilutive number of shares	46,061	45,183

### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Subject to such estimates and judgments is the following:

#### *Long-lived assets and Assets Held for Sale*

At least on an annual basis it is determined whether long-lived assets are impaired. This requires the determination of the value in use of the assets. Estimating the value in use requires management to make an estimate of the expected

future cash flows from the asset and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of long-lived assets and assets held for sale at December 31, 2006 was €13,415 (2005: €20,047)

#### *Deferred Tax Assets*

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing of future taxable profits together with future tax planning strategies. At year end 2006 and 2005 no deferred tax assets were recognized. The unrecognized deferred tax assets at December 31, 2006 were €47,865 (2005: €34,741)

#### *Share-Based Employee Compensation Awards*

Share-based payment transactions are measured by the reference to the fair value at the date on which they are granted. The fair value of the share-based compensation is determined using the Black-Scholes model. The Black-Scholes model involves making assumptions about interest rates, volatilities, market conditions and fluctuation. Due to the nature of these assumptions, such estimates are subject to significant uncertainty. In 2006, the expense related to stock options was €878 (2005: €1,052).

#### *Customer Specific Research and Development*

For the determination of revenue and costs for customer specific research and development contracts, management judgement is required. Hence, it is necessary to make a valuation about the stage of completion and the dependable measurement of the progress made towards completing the particular project.

Actual results may differ from those estimates.

## Changes in accounting policies

The accounting policies are consistent with those of the previous financial year except as follows:

The Company has adopted the following new and amended IFRS and IFRIC interpretations during the year. Adoption of these revised standards and interpretations did not have any effect on the financial statements of the Company.

### *IAS 21 The Effects of Changes in Foreign Exchange Rates*

In May 2006, IAS 21 has been amended. As a result, all exchange differences arising from a monetary item that forms part of the net investment in a foreign operation are recognized in a separate component of equity in the consolidated financial statements regardless of the currency in which the monetary item is denominated. The amendment became effective for financial years beginning on or after January 1, 2006.

*IAS 39 Financial Instruments: Recognition and Measurement Amendment for the fair value option (issued June 2005)* – amended the scope of IAS 39 to restrict the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement. The amendment became effective for financial years beginning on or after January 1, 2006.

### *IFRIC 4 Determining whether an Arrangement contains a Lease*

IFRIC Interpretation 4 as of January 1, 2006 provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. The Interpretation became effective for financial years beginning on or after January 1, 2006.

## Recently issued accounting standards not yet adopted

### *IAS 1 Presentation of Financial Statements*

In August 2005, the IASB issued a complementary amendment to IAS 1 “Presentation of Financial Statements - Capital Disclosures”. The amendment to IAS 1 adds requirements for all entities to disclose the entity’s objectives, policies and processes for managing capital and is effective for annual periods beginning on or after January 1, 2007. The company will adopt this amendment during its financial year ending December 31, 2007. As a result of the first time adoption of this amendment to IAS 1 the Company expects additional disclosure requirements within the notes to its consolidated financial statements.

### *IFRIC 10 Interim Financial Reporting and Impairment<sup>1</sup>*

IFRIC Interpretation 10 as of July 2006 is effective for annual periods beginning on or after November 1, 2006. The interpretation addresses the apparent conflict between the requirements of IAS 34 Interim Financial Reporting and those in other standards on the recognition and reversal in financial statements of impairment losses on goodwill and certain financial assets.

### *IFRIC 11 Group and Treasury Share Transactions<sup>1</sup>*

IFRIC Interpretation 11 IFRS 2 – Group and Treasury Share Transactions was issued in November 2006 and is effective for annual periods beginning on or after March 1, 2007. The Interpretation addresses how to apply IFRS 2 Share-based payments to share-based payment arrangements involving an entity’s own equity instruments or equity instruments of another entity in the same group.

### *IFRS 7 Financial Instruments Disclosures*

In August 2005, the IASB issued IFRS 7 “Financial Instruments: Disclosures”. IFRS 7 introduces new requirements to improve the information on financial instruments that is given in entities’ financial statements and changes or amends certain disclosure requirements. It replaces IAS 30 “Disclosures in the Financial Statements of Banks and Similar Financial Institutions” and some of the requirements in IAS 32 “Financial Instruments: Disclosure and Presentation”. IFRS 7 is effective for annual periods beginning on or after January 1, 2007. The company will adopt this standard during its financial year ending December 31, 2007. As a result of the first time adoption of IFRS 7 the Company expects additional disclosure requirements within the notes to its consolidated financial statements.

### *IFRS 8 Operating Segments<sup>1</sup>*

IFRS 8 Operating Segments which replaces IAS 14 Segment Reporting was issued in November 2006 and is effective for annual periods beginning on or after January 1, 2009. The IFRS requires an entity to adopt the “management approach” to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments.

The Group is still evaluating the effect of these standards and interpretations and expects that their adoption will have no impact on the Company’s financial statements.

<sup>1</sup> Standards or interpretations are not yet endorsed

In addition, the following interpretations and standards have been issued:

Standard	Title	Date of issue
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	January 2006
IFRIC 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	January 2006
IAS 19	Employee Benefits	November 2005
IAS 39	Financial Instruments: Recognition and Measurement <ul style="list-style-type: none"> <li>- Amendment for financial guarantee contracts</li> <li>- Amendment for hedges of forecast intragroup transactions</li> </ul>	August 2005
IFRIC 7	Applying the Restatement Approach	November 2005
IFRIC 8	Scope of IFRS 2	January 2006
IFRIC 9	Reassessment of Embedded Derivatives	June 2006
IFRIC 12 <sup>2</sup>	Service Concession Agreements	November 2006
IFRS 6	Exploration for an Evaluation of Mineral Resources	November 2005

The above listed interpretations and standards did not and will not have an effect on the financial statements as currently they are not applicable for the Company.

### 3. Discontinued Operations

On February 14, 2006 the Company concluded a disposition of its Imaging Division, Dialog Imaging Systems ("DIS"). The business of this division includes the development, design, manufacture, assembly, marketing and delivering of image sensor semiconductors and camera modules. Dialog transferred the assets of its Imaging Division to a newly created entity, Dialog Imaging Systems GmbH, Kirchheim/Teck - Nabern, Germany ("DIS GmbH"), which will issue additional equity interests in exchange for consideration from investors. A total of €22.25 million will be invested in DIS GmbH by private equity investors,

the management team and the Company of which the Company will invest €2 million. In 2006, the Company paid the first tranche amounting to €1.2 million and expects to pay the remaining balance of €0.8 million during the first half of 2007. In the balance sheet, the first payment is shown under investments. The losses from discontinued operations of €1,720 in 2006 are comprised of operating losses incurred before control was legally transferred on February 14, 2006 inclusive of transaction and legal costs. In February 2007 DIS officially changed its company name to Digital Imaging Systems.

<sup>2</sup> IFRIC 12 is not yet endorsed

Losses from the Imaging Division in 2006 and 2005 are comprised of:

(in thousands of €, except per share data)	2006	2005
Revenues	-	1,449
Cost of sales	-	(1,661)
<b>Gross loss</b>	<b>-</b>	<b>(212)</b>
Selling and marketing expenses	-	(593)
General and administrative expenses	(1,720)	(315)
Research and development expenses	-	(7,480)
Write-down of assets to net realizable value	-	-
Intangible assets	-	(2,019)
Property, plant and equipment, net	-	(1,898)
<b>Operating loss</b>	<b>(1,720)</b>	<b>(12,517)</b>
Income tax expense	-	-
<b>Net loss from discontinued operations</b>	<b>(1,720)</b>	<b>(12,517)</b>
Loss per share		
Basic and diluted	(0.04)	(0.28)

The discontinued operation affected the Company's cash flow statements as follows:

(in thousands of €)	2006	2005
Cash used for operating activities	(1,720)	(7,383)
Cash used for investing activities	-	(935)
Cash flows from financing activities	-	11
<b>Cash used for operating, investing and financing activities</b>	<b>(1,720)</b>	<b>(8,307)</b>

#### 4. Restructuring and related impairment charges

In the third quarter of 2006 Dialog Semiconductor decided to transfer the companies 'Wafer Test', 'Final Test' and 'Tape & Reel' divisions to dedicated outsourced assembly and test organisations in Asia. This transfer is expected to be executed in three phases between October 2006 and the second quarter of 2007. Restructuring and related impairment charges regarding the transfer of the wafer test are comprised of €1,190 of employee termination costs that will be paid to 33 employees affected by the transfer and €3,114 of impairment charges.

As a result of the transfer, certain long-lived assets with a former net carrying value of €2,833 are recorded at their current fair value of €1,057. In the balance sheet those assets are classified as assets held for sale within current assets. At the end of the third quarter 2006, the Company reported in its balance sheet an amount of €2,528 for the assets held for

sale. Based on new information received in December 2006, it turned out that some of those assets would now be required to support revenue in 2007. As a result, the Company decided to no longer hold these specific assets for sale and return them to production. Therefore the Company reversed the write down of these assets to market value and booked a depreciation catch up covering the period during which these assets were held for sale. Other long-lived assets with a net carrying value of €365 have been abandoned and certain prepaid expenses of €973 no longer provided any future benefit to the Company. Accordingly, impairment charges totaling €3,114 have been recognized in 2006.

In the fourth quarter of 2006, we booked a €119 restructuring charge to cover severance compensation as a result of reducing our US sales force in line with our reduced revenue.



(in thousands of €)	Workforce Reduction	Asset write-down	other costs	Total
Reserve balance at January 1, 2006	-	-	-	-
Initial Charges	1,190	3,315	1	4,506
Additional Charges	115	408	219	742
Reversal of write-down		(609)		(609)
Payments made	(270)	-	(220)	(490)
Amount charged against assets	-	(3,114)	-	(3,114)
Reserve balance at December 31, 2006	1,035	-	-	1,035

## 5. Other Disclosures to the Statements of Operation

Result before income taxes is stated after charging:

(in thousands of €)	2006	2005
Auditors' remuneration 1)		
audit	(170)	(192)
tax fees	-	(60)
	(170)	(252)
Depreciation of property, plant and equipment	(5,377)	(7,619)
Amortization of intangible assets	(2,946)	(2,807)
Personnel costs		
Wages and salaries	(18,128)	(19,759)
Social and security costs	(2,830)	(3,027)
Share-based payment	(878)	(1,052)
Other pension costs	(611)	(653)
	(22,447)	(24,491)
Included in revenues		
Revenue from customer specific research and development contracts	916	887
Included in cost of sales		
Costs in relation to customer specific research and development contracts	(916)	(887)
Amount of inventory recognized as expense	(42,106)	(79,591)
Write-downs of inventories recognized as an expense	(552)	(6,576)
Included in general and administration expenses		
Write-downs of inventories recognized as an expense	(5,441)	-
Write-downs of trade accounts receivable 2)	(2,006)	-

1) The auditors' remuneration in 2006 relates to our new auditor Ernst & Young. In 2005, the amount relates to our former auditor KPMG.

2) Related revenue is recognized in the current fiscal year. For further information see note 8.

The average staff numbers of persons employed by the group (including the executive director) during the year, analyzed by category, was as follows:

	2006	2005
Research and Development	118	149
Production	74	80
Sales and Marketing	21	23
Admin	18	20
IT	10	8
	<b>241</b>	<b>280</b>

## 6. Income Taxes

Loss before income taxes consists of the following:

(in thousands of €)	2006	2005
Germany	(29,497)	(9,660)
Foreign	(4,016)	1,611
	<b>(33,513)</b>	<b>(8,049)</b>

Provisions for income taxes are as follows:

(in thousands of €)	2006	2005
<b>Current taxes:</b>		
Germany	336	-
Foreign	(38)	(43)
<b>Deferred taxes:</b>		
Germany	-	(15,004)
Foreign	(178)	(249)
<b>Income tax benefit (expense)</b>	<b>120</b>	<b>(15,296)</b>

On December 12, 2006 the "Bill on the tax features for the Introduction of the European Company and Amendment of other Tax rules (SEStG)" was enacted. This new legislation changes the rules on the refund of the corporation tax credit in Germany.

In the past, the refund of the corporation tax credit was dependent upon profit distributions. Under the new rule, generally effective December 31, 2006, the law provides for an ultimate refund claim of any dividend distributions.

According to the new rule, the corporation tax credit will be assessed as of December 31, 2006. Thus, the refund claim arises as of this date. Based on the assessment (without the prior requirement of a distribution), the company is entitled to receive a tax refund of €414 to be paid out in ten equal amounts during the period from 2008 to 2017. The annual payments become due on September 30 of each year. The current tax income of €336 shown for Germany relates to

this new tax legislation and represents the discounted amount of the €414. In the balance sheet the amount is shown under "assets for current tax".

Although Dialog is a UK company, its principal operations are located in Germany and all of its operating subsidiaries are owned by its German subsidiary. Accordingly, the following information is based on German corporate tax law. The Company's statutory tax rate for its German subsidiary is 25%. When including the impact of the solidarity surcharge of 5.5%, the federal corporate tax rate amounts to 26.375%. A reconciliation of income taxes determined using the German corporate tax rate of 26.375% plus the after federal tax benefit rate for trade taxes of 11.225%, for a combined statutory rate of 37.6%, is as follows:

(in thousands of €)	2006	2005
Expected benefit for income taxes	12,601	3,026
Foreign tax rate differential	(217)	190
Repayment of German corporation tax credit	336	-
Non-deductible portion of stock-based compensation	(191)	(276)
Unrecognized deferred tax assets	(13,159)	(18,390)
Tax deduction related to the valuation of available for sale securities	3	81
Adjustments recognized for tax of prior periods	795	(10)
Other	(48)	83
<b>Actual income (expense) for income taxes</b>	<b>120</b>	<b>(15,296)</b>

Deferred income tax assets and liabilities are summarized as follows:

(in thousands of €)	Dec 31, 2006	Dec 31, 2005
Property, plant and equipment	469	493
Net operating loss and tax credit carryforwards	42,720	28,407
Liabilities	3,870	5,323
Deferred taxes in relation to credits	1,149	1,123
Other	116	103
<b>Deferred tax assets</b>	<b>48,324</b>	<b>35,449</b>
Property, plant and equipment	(457)	(706)
Other	(2)	(2)
<b>Deferred tax liabilities</b>	<b>(459)</b>	<b>(708)</b>
<b>Net deferred tax assets</b>	<b>47,865</b>	<b>34,741</b>
Recognized net deferred tax assets	-	-
<b>Unrecognized deferred tax assets</b>	<b>47,865</b>	<b>34,741</b>

The movement in deferred tax assets recognized in the balance sheet is reconciled as follows:

(in thousands of €)	2006	2005
At start of year	-	15,245
Credit / (charge) for the year	(178)	(15,253)
Deferred tax recognized in Equity	178	8
<b>Deferred tax</b>	<b>-</b>	<b>-</b>

Tax loss carryforwards and unrecognized deferred tax assets are summarized as follows:

	December 31, 2006			December 31, 2005		
	Tax loss carryforwards			Tax loss carryforwards		
	Total	for which no deferred tax asset was recognized	unrecognized deferred tax asset	Total	for which no deferred tax asset was recognized	unrecognized deferred tax asset
Germany	106,966	106,966	42,502	72,353	72,353	30,729
UK	8,103	8,103	4,066	4,811	4,520	2,993
US						
Federal	2,894	2,894	1,005	1,811	1,811	807
State	2,877	2,877	264	1,662	1,662	212
Japan	-	-	28	-	-	-
<b>Total</b>			<b>47,865</b>			<b>34,741</b>

In assessing whether the deferred tax assets can be used, management considers the likeliness that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods, in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, benefits that could be realized from available tax planning strategies and other positive and negative factors in making this assessment. Considering the weight given to cumulative losses incurred in Germany over the six-year period ended December 31, 2006, as well as the inherent uncertainties in projecting future taxable income, pursuant to IAS 12, management concluded that tax losses may not ultimately be realized.

Consequently, the Company did not recognize an additional deferred tax asset of €13,159 as of December 31, 2006 and €18,390 as of December 31, 2005.

The tax loss carry forwards in the US will expire between 2007 and 2020; other tax loss carry forwards have no expiration date.

Included in unrecognized deferred tax assets is an amount of €1,149 (2005: €1,123) (the differences come from foreign currency adjustments) in relation to tax credits in the UK. This asset may be recovered against future taxable profits derived from certain overseas dividends for the company concerned.

## 7. Available-for-sale financial assets

The Company has invested in highly liquid "investment grade" rated debt based funds classified as available for sale. The fair value of the securities is based on quoted market

prices. The aggregate costs, fair values, carrying amounts and unrealized losses of the Group's financial instruments are as follows:

(in thousands of €)	At December 31, 2006			At December 31, 2005		
	Cost	Fair value	Unrealized loss	Cost	Fair value	Unrealized loss
Debt based funds	15,201	14,681	(520)	15,201	14,890	(311)

In 2006, unrealized losses of €200 that had been previously recognized directly in equity were reclassified into net loss. This was justified by the fact that one of our investments showed a prolonged decline in the fair value below its costs. In 2005, realized losses of €16 on the sale of available for sale securities were reclassified into net loss.

### Contracted maturities of financial instruments

All financial instruments are contracted to mature within one year or less and/or incorporate a floating interest rate that is reset as market rates change.

## 8. Trade Accounts Receivable, net

The recorded trade accounts receivable for which an impairment has been recognized, was €2,135 and €15 at December 31, 2006 and 2005, respectively. The related allowance for doubtful accounts was €1,939 and €8 at December 31, 2006 and 2005, respectively. The increase of the allowance for doubtful accounts mainly results from a write down of accounts receivable of €2,006 related to BenQ Mobile GmbH which went into insolvency in the beginning of the fourth quarter of 2006.

The allowance for doubtful accounts developed as follows:

(in thousands of €)	2006	2005
Allowance for doubtful accounts at beginning of year	8	17
Additions charged to bad debt expense	2,023	133
Write-offs charged against the allowance	-	(131)
Reductions charged to bad debt expense	(6)	(11)
Effect of movements in foreign currency	(86)	-
<b>Allowance for doubtful accounts at end of year</b>	<b>1,939</b>	<b>8</b>

## 9. Inventories

Inventories are comprised of the following:

(in thousands of €)	At December 31, 2006	At December 31, 2005
Raw materials	624	5,797
Work-in-process	2,995	7,193
Finished goods	2,040	4,165
	<b>5,659</b>	<b>17,155</b>

The inventory reduction was partly the result of a write down of €5,441 related to BenQ Mobile GmbH which went into insolvency in the beginning of the fourth quarter of 2006.

The carrying amount of inventories carried at fair value less costs to sell at December 31, 2006 is €1,004 (2005: €0)

As per December 31, 2006 all incurred external costs for customer related research and development projects have been charged to the customer in accordance with agreed upon milestone plans. Consequently, as per December 31, 2006 the inventories do not include work in progress related to research and development projects in accordance with IAS 11.

## 10. Prepaid Expenses

In 2000, the Company paid \$2.5 million as an advance payment to one of its suppliers. Those advance payments are classified in the balance sheet line items "Prepaid expenses". Through the years the advance payment was refunded in proportion to the Company's purchases of wafers from this

supplier. In connection with the restructuring prescribed in note 4, the outstanding balance of those advance payments no longer provided any future benefit for the company. Accordingly impairment charges of €973 thousand were recognized in 2006.

## 11. Property, Plant and Equipment, net

A summary of activity for property, plant and equipment for the years ended December 31, 2006 and 2005 is as follows:

(in thousands of €)	Test equipment	Leasehold improvements	Office and other equipment	Advance payments	Total
<b>Cost</b>					
Balance at January 1, 2005	60,513	897	15,710	1,723	78,843
Effect of movements in foreign currency	5	37	203	-	245
Acquisitions	1,558	11	1,703	764	4,036
Reclassifications	853	-	-	(904)	(51)
Disposals	(179)	-	(228)	-	(407)
<b>Balance at December 31, 2005 / January 1, 2006</b>	<b>62,750</b>	<b>945</b>	<b>17,388</b>	<b>1,583</b>	<b>82,666</b>
Effect of movements in foreign currency	3	6	(1)	-	8
Acquisitions	1,610	5	1,217	-	2,832
Reclassifications	1,583	-	-	(1,583)	-
Reclassifications to assets held for sale 1)	(9,313)	-	-	-	(9,313)
Disposals	(4,183)	(166)	(4,662)	-	(9,011)
<b>Balance at December 31, 2006</b>	<b>52,450</b>	<b>790</b>	<b>13,942</b>	<b>-</b>	<b>67,182</b>
<b>Depreciation and impairment losses</b>					
Balance at January 1, 2005	(45,227)	(596)	(11,782)	-	(57,605)
Effect of movements in foreign currency	(5)	(23)	(171)	-	(199)
Depreciation charge for the year	(5,035)	(53)	(2,531)	-	(7,619)
Write-down of imaging assets 2)	(1,016)	(11)	(871)	-	(1,898)
Disposals	138	-	227	-	365
<b>Balance at December 31, 2005 / January 1, 2006</b>	<b>(51,145)</b>	<b>(683)</b>	<b>(15,128)</b>	<b>-</b>	<b>(66,956)</b>
Effect of movements in foreign currency	(3)	(11)	(5)	-	(19)
Depreciation charge for the year	(4,201)	(29)	(1,147)	-	(5,377)
Reclassifications to assets held for sale 1)	6,480	-	-	-	6,480
Disposals	3,825	81	4,204	-	8,110
<b>Balance at December 31, 2006</b>	<b>(45,044)</b>	<b>(642)</b>	<b>(12,076)</b>	<b>-</b>	<b>(57,762)</b>
<b>Net book value</b>					
At January 1, 2005	15,286	301	3,928	1,723	21,238
At December 31, 2005 / January 1, 2006	11,605	262	2,260	1,583	15,710
At December 31, 2006	7,406	148	1,866	-	9,420

1) For further information see note 4 – Restructuring and related impairment charges

2) Write-down of imaging assets: for further information see note 3 – Discontinued Operations

## 12. Intangible Assets

A summary of activity for intangible assets for the years ended December 31, 2006 and 2005 is as follows:

(in thousands of €)	Purchased software, licenses and other	Purchased patents	Total
<b>Cost</b>			
<b>Balance at January 1, 2005</b>	<b>8,993</b>	<b>3,008</b>	<b>12,001</b>
Effect of movements in foreign currency	61	-	61
Acquisitions	8,803	-	8,803
Reclassifications	51	-	51
Disposals	(610)	-	(610)
<b>Balance at December 31, 2005 / January 1, 2006</b>	<b>17,298</b>	<b>3,008</b>	<b>20,306</b>
Effect of movements in foreign currency	11	-	11
Acquisitions	412	-	412
Disposals	(8,150)	(3,008)	(11,158)
<b>Balance at December 31, 2006</b>	<b>9,571</b>	<b>-</b>	<b>9,571</b>
<b>Amortization and impairment losses</b>			
<b>Balance at January 1, 2005</b>	<b>(8,014)</b>	<b>(843)</b>	<b>(8,857)</b>
Effect of movements in foreign currency	(58)	-	(58)
Amortization charge for the year	(2,487)	(320)	(2,807)
Write-down of imaging assets 1)	(174)	(1,845)	(2,019)
Disposals	610	-	610
<b>Balance at December 31, 2005 / January 1, 2006</b>	<b>(10,123)</b>	<b>(3,008)</b>	<b>(13,131)</b>
Effect of movements in foreign currency	(12)	-	(12)
Amortization charge for the year	(2,946)	-	(2,946)
Disposals	4,708	3,008	7,716
<b>Balance at December 31, 2006</b>	<b>(8,373)</b>	<b>-</b>	<b>(8,373)</b>
<b>Net book value</b>			
<b>At January 1, 2005</b>	<b>979</b>	<b>2,165</b>	<b>3,144</b>
<b>At December 31, 2005 / January 1, 2006</b>	<b>7,175</b>	<b>-</b>	<b>7,175</b>
<b>At December 31, 2006</b>	<b>1,198</b>	<b>-</b>	<b>1,198</b>

1) Write-down of imaging assets: for further information see note 3 - Discontinued Operations

During the years ended December 31, 2006 and 2005, the Company acquired software and licenses for a total purchase price of €412 and €8,803 respectively. The acquisitions in 2006 mainly consist of Software. The 2005 acquisitions primarily relate to three year licensing contracts for the use of electronic design automated tools. In connection with these contracts, the Company made payments of €4,450 and recorded the net present value of the unpaid portion of €3,275 (due in quarterly instalments) as a liability. In 2006 the company made payments of in total €599 for the licensing contracts. Two of those contracts with a remaining net book value of €3,308 were cancelled. The remaining net

present value of the unpaid portion recorded as a liability was €2,863. Accordingly, the difference of €445 was recognized as an expense.

The expected weighted average useful life of the acquired intangible assets is 3 years. The aggregate amortization expense for the years ended December 31, 2006 and 2005 was €2,946 and €2,807 respectively. Amortization expense of the gross carrying amount of intangible assets at December 31, 2006 is estimated to be €490 in 2007, €396 in 2008, €166 in 2009, €46 in 2010 and €0 in 2011.

## 13. Provisions

The Company issues various types of contractual product warranties under which it guarantees the performance of products delivered for a certain period or term. The provision

is estimated based on historical warranty data. Regarding the provision for restructuring please see note 4. We expect that all provisions will mature within the next twelve months.

The changes in the provision are summarized as follows (in thousands of €):

	Balance at January 1, 2006	Currency change	Additions	Used	Released	At December 31, 2006
Obligations for product warranties	194	-	-	(144)	-	50
Restructuring	-	-	1,305	(270)	-	1,035
<b>Total</b>	<b>194</b>	<b>-</b>	<b>1,305</b>	<b>(414)</b>	<b>-</b>	<b>1,085</b>

## 14. Other current liabilities

Other current liabilities are comprised of the following:

(in thousands of €)	At December 31, 2006	At December 31, 2005
Obligations for personnel and social expenses	1,139	1,572
Outstanding invoices and other obligations	2,257	1,806
Outstanding payables for software licenses	83	776
VAT liabilities	-	560
Other	297	389
	<b>3,776</b>	<b>5,103</b>

## 15. Shareholders' Equity and Other Reserves

### Ordinary shares

At December 31, 2006 and 2005, Dialog had authorized 104,311,860 ordinary shares with a par value of £0.10 per share, of which 46,068,930 shares were issued and outstanding. All of the Company's stock is issued in the form of bearer shares, all shares are fully paid.

On September 24, 2004, the Company completed an offering of 2,000,000 previously unissued ordinary shares at £0.10 per share to its employee share option trust ("Trust"), to make such shares available for the exercise of stock option rights that had previously been granted to employees. At December 31, 2006 and December 31, 2005 the Trust continued to hold 1,178,957 and 1,691,155 shares respectively. These shares are legally issued and outstanding, but are not considered issued

and outstanding for accounting purposes and accordingly have been reported in the caption "employee stock purchase plan shares" as a reduction of shareholders' equity.

### Share premium

The account comprises additional paid-in capital in connection with the issue of shares.

### Accumulated deficit

The accumulated deficit comprises losses and non-distributed earnings of consolidated group companies. Due to the accumulated deficit, the Company cannot pay a dividend and does not plan to pay dividends in the foreseeable future.

### Accumulated other comprehensive income

The related tax effects allocated to each component of other comprehensive income (loss) for the years ended December 31, 2006 and 2005 are as follows:

(in thousands of €)	2006			2005		
	Pretax	Tax effect	Net	Pretax	Tax effect	Net
Unrealized (losses) gains on available for sale securities	(9)	(12)	(21)	(271)	-	(271)
Currency translation adjustment	(150)	190	40	137	2	139
<b>Other comprehensive income (loss)</b>	<b>(159)</b>	<b>178</b>	<b>19</b>	<b>(134)</b>	<b>2</b>	<b>(132)</b>

## 16. Pension Scheme

The group operates defined contribution pension schemes. The pension cost charge for the year represents contributions payable by the group to the funds and amounted to €611

(2005: €653). At December 31, 2006, contributions amounting to €115 (2005: €8) were payable to the funds and are included in creditors.

## 17. Stock-based Compensation

### a) Stock option plan

On August 7, 1998, the Company adopted a stock option plan ("Plan") under which employees and executive directors may be granted from time to time, at the discretion of the Board, stock options to acquire up to 3,840,990 shares of the Company's authorized but un-issued ordinary shares. On May 16, 2002 the shareholders of the Company approved a resolution increasing the maximum amount of stock options which may be granted by the Company at any time to 15% of the Company's issued share capital on a diluted basis. At December 31, 2006, 8,129,811 shares could be issued.

Except as provided below in the relation to the Chief Executive, stock options granted to employees are granted with an exercise price not less than the quoted price at the date of grant. Stock options granted prior to October, 31. 2006 have terms of ten years and vest over periods of one to five years from the Date of Grant. On June 19, 2006 the company adopted a revised stock option plan under which stock options now have a seven years life and vest monthly over a period of 1 to 48 months. The new stock options may not be exercised until they have been held for one calendar year

from Date of Grant. The new rules were implemented on grants on or after October 31, 2006.

161,475 options with an exercise price of €0.10 have been granted in February 2006 to the Chief Executive, Dr. Bagherli, and are subject to the achievement of performance and market targets to vest in eight equal semi-annual tranches between March 31, 2006 and September 30, 2009.

The fair value of all grants in the two-year period ended December 31, 2006 is estimated using the Black-Scholes option pricing model. Expectations of early exercise are considered in the determination of the expected life of the options. The Company does not have adequate historical development of the share price, especially due to material unusual effects in the stock market in recent years. Furthermore, an implicit volatility cannot be determined as none of the Company's options are actively traded. The Company has, therefore, based its calculation of expected volatility on the historical development of other Companies in its business segment.



The following assumptions were used for stock option grants for the years ended December 31, 2006 and 2005:

	2006	2005
Expected dividend yield	0%	0%
Expected volatility	21%-49%	18%-52%
Risk free interest rate	4.1%	2.3%(3.3)%
Expected life (in years)	2.0 to 6.0	1.0 to 7.0
Weighted average share price (in €)	1.40	2.31
Weighted average exercise price (in €)	1.27	2.30
Weighted-average fair value (in €)	0.51	1.31

Stock option plan activity for the years ended December 31, 2006 and 2005 was as follows:

	2006		2005	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	3,850,008	2.45	3,299,406	2.34
Granted	3,012,080	1.27	952,000	2.30
Exercised	(512,198)	0.41	(305,338)	0.27
Forfeited	(848,109)	2.85	(96,060)	3.13
Outstanding at end of year	5,501,781	1.94	3,850,008	2.45
Options exercisable at year end	2,030,276	2.25	2,250,648	2.03

The weighted average share price at the date of exercise of options was €1.53 and €2.45 in the years ended December 31, 2006 and 2005 respectively.

The following table summarizes information about stock options outstanding at December 31, 2006:

Range of Exercise Prices	Options outstanding		Options exercisable		
	Number outstanding at December 31, 2006	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number exercisable at December 31, 2006	Weighted average exercise price
€0.00 - 2.98	3,945,481	6.5	€1.19	988,916	€0.83
€3.00 - 8.00	1,556,300	7.1	€3.82	1,041,360	€3.60
€0.00 - 8.00	5,501,781	6.7	€1.94	2,030,276	€2.25

#### b) ESOP Trust

The Company established an employee share option trust (the "Trust"). The Trust purchases shares in the Company for the benefit of employees under the Company's share option scheme. At December 31, 2006 the Trust held 1,178,957 shares.

approved a stock option plan for non-executive directors. Each non-executive Director is entitled to an initial grant of 50,000 options vesting over 4 years and each year thereafter, as soon as possible after the Annual Shareholder Meeting a further 20,000 options vesting over 12 months. Options are exercisable at the market price prevailing at the date of grant.

#### c) Non-Executive Directors Stock Option Plan

At the 2006 Annual Shareholders Meeting, shareholders

## 18. Commitments

The Company leases all of its office facilities, office and test equipment and vehicles under operating leases. In addition the Company has contracted consulting services and software licenses related to CAD (computer aided designs) until De-

cember 29, 2009. Total rentals under these agreements, charged as an expense in the statement of operations, amounted to €1,931 and €2,906 for the years ended December 31, 2006 and 2005 respectively.

Effective December 30, 2006 the Company has entered into a software license agreement amounting to \$7.2 million (€5.5 million). The contract period is three years and quarterly payments over the contract period in the amount of \$600 are agreed upon. In case the total volume of the contract term is used prior to the end of the contract period the remaining contract fee becomes due.

Future minimum lease payments under rental and lease agreements, which have initial or remaining terms in excess of one year at December 31, 2006, are as follows:

(in thousands of €)	Operating leases	
	2006	2005
within 1 year	3,506	3,817
between 1 and 2 years	2,821	2,573
between 2 and 3 years	1,325	1,980
between 3 and 4 years	209	1,068
between 4 and 5 years	158	197
Thereafter	0	154
<b>Total</b>	<b>8,019</b>	<b>9,789</b>

## 19. Segment Reporting

Segment information is presented according to Dialog's business and geographical segments. The primary format, business segments, is based on the Company's principal sales markets.

### a) Business Segments

The company's business segments are:

#### Wireless Segment:

The wireless segment includes our Power Management and Audio ICs and the Display Drivers which are used in portable electronic products such as mobile phones and other hand-held devices.

At December 31, 2006, the Company had unused short-term credit lines of €12,500. There were no amounts outstanding under these credit lines at December 31, 2006.

The Company has contractual commitments for the acquisition of property, plant and equipment in 2007 of €527 and for the acquisition of intangible assets of €13.

The Company will invest €2 million into DIS GmbH, of which the first tranche amounting to €1.2 million was paid in 2006. The company expects to pay the remaining balance of €0.8 million during the first half of 2007. For further information see note 3.

#### Automotive and Industrial Segment:

In the automotive and industrial market our products address the safety, management and control of electronics systems in the car and for industrial applications.

#### Imaging segment:

Prior to its discontinuance the business of this division included the development, design, manufacture and assembly of image sensor semiconductors and camera modules.

(in thousands of €)	2006						2005					
	Wireless	Automotive / Industrial	Corporate	Total continued operations	Imaging (discontinued operations)	Total	Wireless	Automotive / Industrial	Corporate	Total continued operations	Imaging (discontinued operations)	Total
Revenues 1)	43,953	27,315	-	71,268	-	71,268	103,359	26,047	-	129,406	1,449	130,855
R&D expenses	15,470	5,415	-	20,885	-	20,885	16,071	4,553	-	20,624	7,480	28,104
Operating profit (loss)	(23,597)	(667)	(6,822)	(31,086)	(1,720)	(32,806)	4,514	1,048	(2,863)	2,699	(12,517)	(9,818)
Depreciation / amortization	6,001	2,322	-	8,323	-	8,323	6,882	2,243	-	9,125	1,301	10,426
Impairment losses	7,999	-	3,114	11,113	-	11,113	6,576	-	-	6,576	-	6,576
Investments	2,362	882	-	3,244	-	3,244	8,444	3,460	-	11,904	935	12,839
	Dec 31, 2006						Dec 31, 2005					
Total assets	12,371	10,048	39,419	61,838	1,229	63,067	57,276	13,787	31,810	102,873	265	103,138
Liabilities	6,990	2,463		9,453	-	9,453	12,817	3,264	990	17,071	169	17,240

1) All revenues are from sales to external customers.

Corporate expenses include the holding company, the restructuring expenses and other expenses not specifically attributable to the business segments. Corporate assets include certain financial assets such as cash and cash equivalents, marketable securities and in 2006 the assets held for sale. Corporate liabilities include liabilities of the holding company and other liabilities not specifically attributable to business segments.

Segment assets and segment liabilities comprise all assets and liabilities employed by the relevant business segment to generate the operating segment profit or loss.

Investments comprise additions to property, plant and equipment and intangible assets.

In 2006 and 2005 the Company had no inter-segment sales, income, expenses, receivables, payables or provisions.

All revenues and expenses relating to discontinued operations (see note 3) are shown within the imaging segment.

## b) Geographical Segments

(in thousands of €)	2006	2005
<b>Revenues</b>		
Germany	9,189	25,446
Austria	10,368	8,883
Hungary	10,033	7,646
Other European countries	2,318	3,233
Japan	11,065	18,886
China	9,107	21,558
Other Asian countries	9,392	33,533
Other countries	9,796	11,670
<b>Total Revenues</b>	<b>71,268</b>	<b>130,855</b>
<b>Investments</b>		
Germany	3,121	12,755
Japan	20	25
United Kingdom	101	46
USA	2	13
<b>Total Investments</b>	<b>3,244</b>	<b>12,839</b>

(in thousands of €)	At December 31, 2006	At December 31, 2005
<b>Assets</b>		
Germany	61,721	101,042
Japan	472	553
United Kingdom	422	700
USA	452	843
<b>Total Assets</b>	<b>63,067</b>	<b>103,138</b>

Revenues are allocated to countries based on the location of the shipment destination. Segment investments and assets are allocated based on the geographical location of the asset.

## 20. Financial risk management objectives and policies

The Company's principal financial instruments comprise cash and cash equivalents, short-term deposits and securities. The main purpose of these financial instruments is to raise finance for the Company's operations. The Company has other financial instruments which mainly comprise trade receivables and trade payables which arise directly from its operations.

During the year ended December 31, 2006 and previous financial years, the Company did not use derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. The Company does not hold or issue derivative financial instruments for trading purposes.

Exposure to currency, interest rate and credit risks arises in the normal course of the Company's business.

### *Interest risk*

The Company earns interest from bank deposits and they use money market deposits with highly rated financial institutions. During the year, the Company has held cash on deposit with a range of maturities from one week to one month. This can vary in view of changes in the underlying currency's interest rates and the Company's cash requirements.

The Company has invested in highly liquid "investment grade" rated debt based funds classified as available for sale. Those funds are contracted to mature within one year or less and/or incorporate a floating interest rate that is reset as market rates change.

The Company has no long-term debt and no amounts outstanding under short-term credit facilities as at December 31, 2006 (2005: € nil).

### *Currency Risk*

The reporting currency for our consolidated financial statements is the Euro. Accordingly, foreign exchange risks arise from transactions, recognised assets and liabilities and net investments of companies whose functional currency is not the Euro.

The currencies giving rise to these exposure risks are primarily the US dollar and Pound Sterling. The majority of the Company's revenue and material expenses are denominated in US dollars. The majority of other cost of sales and operating expenses are denominated in Euros and Pounds Sterling.

The Company does not use foreign exchange instruments to hedge its currency risk. The Company ensures that the net exposure is kept to an acceptable level by selling or buying

foreign currencies (primarily US dollars and Pounds Sterling) spot when required.

The Company considers the use of financial instruments such as foreign exchange contracts but did not enter into any such contracts during the current and preceding financial years.

#### *Credit risk*

For the credit risk relating to trade accounts receivable please refer to Note 1c.

With respect to credit risk arising from other financial assets of the Company, which comprise cash and cash equivalents,

available-for-sale financial investments, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

#### *Liquidity risk*

At December 31, 2006, the Company had cash and cash equivalents of €24.3 million (2005: €16.9 million) and marketable securities of €14.7 million (2005: €14.9 million). The Company periodically monitors its risk to a shortage of funds using quarterly cash flow forecasts.

## 21. Transactions with Related Parties

Timothy Anderson, who was a member of the Company's Board of Directors until February 1, 2006, is also a partner in the law firm Reynolds Porter Chamberlain, which frequently acts as the Company's legal adviser. Fees paid by Dialog Semiconductor Plc to Reynolds Porter Chamberlain for legal

services rendered were €259 and €257 in 2006 and 2005, respectively. Fees paid by Dialog's subsidiaries to Reynolds Porter Chamberlain were €24 and €30 in 2006 and 2005, respectively.

Compensation of key management personnel of the company is as follows:

	2006	2005
Short term employee benefits	2,071	2,033
Buy out 1)	202	0
other long term benefits	90	42
Termination benefits	91	0
Share based payments	658	416
	<b>3,112</b>	<b>2,491</b>

1) The amount shown under "buy out" relates to a payment in connection with a buy out provision for Dr. Bagherli's previous employment.

## 22. Subsequent event

With the announcement we made in late September 2006 to transfer our Wafer Test, Final Test and Tape & Reel activity from Nabern Germany to the Far East, we now expect that by the end of the second quarter of 2007 all our manufacturing cost will be USD denominated. This triggering event is now effectively making Dialog a USD functional company.

As a result, the Company announced on February 28, 2007 that it will change the group functional and reporting currency from EURO to USD effective January 1, 2007. In line with this decision, the Company has converted most of its security holdings from EURO to USD denominated liquid assets.

On the following pages information regarding the holding company Dialog Semiconductor Plc is given.

# Dialog Semiconductor PLC

## Company Financial Statements

Registered number 3505161

### Company Balance sheet

(in thousands of €)	Notes	At December 31, 2006	At December 31, 2005
<b>ASSETS</b>			
Cash and cash equivalents		1,228	7,748
Available-for-sale financial assets	7	14,681	14,890
Amounts owed by group undertakings		21,947	30,275
Prepaid expenses		16	38
Other current assets		339	371
<b>Total current assets</b>		<b>38,211</b>	<b>53,322</b>
Investments	23	73,986	57,986
Amounts owed by group undertakings (due after more than one year)		-	3,418
<b>Total non-current assets</b>		<b>73,986</b>	<b>61,404</b>
<b>TOTAL ASSETS</b>		<b>112,197</b>	<b>114,726</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Amounts owed by group undertakings		-	186
Trade accounts payable		72	65
Other current liabilities		649	275
<b>Total current liabilities</b>		<b>721</b>	<b>526</b>
Ordinary Shares		7,028	7,028
Share Premium		168,969	168,832
Retained deficit		(64,025)	(61,110)
Other reserves		(320)	(299)
Employee stock purchase plan shares		(176)	(251)
<b>Total Shareholders' equity</b>	13	<b>111,476</b>	<b>114,200</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>112,197</b>	<b>114,726</b>

The accounting policies of the Company are consistent with the accounting policies of the Group set out in note 2.

No profit and loss account is presented by the Company as permitted by Section 230 of the Companies Act 1985.

Amounts owed by group undertaking are falling due greater than one year.

These financial statements were approved by the board of directors on 10 April 2007 and were signed on its behalf by:

Dr. Jalal Bagherli  
Director

## Dialog Semiconductor Plc

### Company Statements of Cash Flows

(in thousands of €)	2006	2005
<b>Cash flow from operating activities:</b>		
Net loss	(2,915)	(51,614)
Adjustments to reconcile net loss to net cash used for operating activities:		
Write-down of investment in GmbH	-	54,268
Foreign exchange (gain) / loss from revaluation of intercompany receivables and liabilities	1,357	(2,886)
Interest income, net	(1,861)	(1,998)
Income tax expense (income)	(12)	264
Changes in working capital:		
Prepaid expenses	22	(28)
Trade accounts payable	7	(7)
Other assets and liabilities	575	577
<b>Cash used for operations</b>	<b>(2,827)</b>	<b>(1,424)</b>
Interest received	1,004	431
<b>Cash used for operating activities</b>	<b>(1,823)</b>	<b>(993)</b>
<b>Cash flow from investing activities:</b>		
Capital contribution into Dialog Semiconductor GmbH	(16,000)	-
Sale of marketable securities	-	2,009
<b>Cash (used for) provided by investing activities</b>	<b>(16,000)</b>	<b>2,009</b>
<b>Cash flow from financing activities:</b>		
Amounts owed by group undertakings	11,091	(3,216)
Sale of employee stock purchase plan shares	212	96
Cash provided by (used for) financing activities	11,303	(3,120)
<b>Cash used for operating, investing and financing activities</b>	<b>(6,520)</b>	<b>(2,104)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(6,520)</b>	<b>(2,104)</b>
Cash and cash equivalents at beginning of period	7,748	9,852
Cash and cash equivalents at end of period	1,228	7,748

## Dialog Semiconductor Plc

### Company Statement of changes in equity

(in thousands of €)	Ordinary Shares	Share Premium	Retained deficit	Available for sale securities	Employee stock purchase plan shares	Total
Balance at December 31, 2004	7,028	168,782	(9,496)	(28)	(297)	165,989
Net loss	-	-	(51,614)	-	-	(51,614)
Other comprehensive income (loss)	-	-	-	(271)	-	(271)
Total comprehensive loss						(51,885)
Sale of employee stock purchase plan shares	-	50	-	-	46	96
<b>Balance at December 31, 2005</b>	<b>7,028</b>	<b>168,832</b>	<b>(61,110)</b>	<b>(299)</b>	<b>(251)</b>	<b>114,200</b>
Net loss	-	-	(2,915)	-	-	(2,915)
Other comprehensive income (loss)	-	-	-	(21)	-	(21)
Total comprehensive loss						(2,936)
Sale of employee stock purchase plan shares	-	137	-	-	75	212
<b>Balance at December 31, 2006</b>	<b>7,028</b>	<b>168,969</b>	<b>(64,025)</b>	<b>(320)</b>	<b>(176)</b>	<b>111,476</b>

### Notes to the company financial statements

#### 23. Investments

This represents the investment of the Company in Dialog Semiconductor GmbH. On December 29, 2006 the board of directors concluded a capital contribution into Dialog Semiconductor GmbH in amount of €16.0 million to prevent a negative equity situation at this subsidiary. Investments in subsidiaries are stated at cost less any provision for impairment in value.

#### 24. Deferred tax

(in thousands of €)	At December 31, 2006	At December 31, 2005
Net operating loss and tax credit carryforwards	1,765	1,263
Deferred taxes in relation to credits	1,149	1,123
Other	98	93
<b>Net deferred tax assets</b>	<b>3,012</b>	<b>2,479</b>
Recognized net deferred tax assets	-	-
<b>Unrecognized deferred tax assets</b>	<b>3,012</b>	<b>2,479</b>

For further information on deferred taxes see note 6.

#### 25. Auditors remuneration

(in thousands of €)	2006	2005
Auditors' remuneration - audit	73	157
Auditors' remuneration - tax fees	-	5

#### 26. Share Capital and share options

Details of the company's share capital and share options are set out in notes 15 and 17.

#### 27. Staff numbers and costs

The company does not have any employees.

#### 28. Events since the balance sheet date

Details are set out in note 22 to the Consolidated Financial Statements.



# Corporate Governance

## Corporate Governance Principles

### High corporate governance standards

Dialog Semiconductor Plc is committed to comply with German standards for fair and responsible corporate governance. Accordingly, Dialog Semiconductor (as a foreign company listed on the German stock exchange) has established and published its own Corporate Governance Principles corresponding in substance to the provision of the “German Declaration on Corporate Governance”. Also, Dialog has adopted a Code of Business Conduct and Ethics.

Full details of the Corporate Governance Principles and the Code of Business Conduct and Ethics are published on Dialog Semiconductor’s internet site ([www.dialog-semiconductor.com](http://www.dialog-semiconductor.com)). In summary, the Corporate Governance Principles cover the following key areas:

### Shareholders rights and the Annual General Meeting (AGM)

Each share carries one vote and there are no multiple voting rights or preferential voting rights (golden shares). All financial and independent audit reports are presented to the AGM. The AGM is where the directors will obtain authorization to approve and pass resolutions related to company business, such as auditor’s remuneration and issue of new shares. The Company publishes key information relating to the AGM on its web site on the day of the annual meeting.

### Board of Directors’ compensation

Directors’ compensation, shareholdings and options are disclosed in note 21 to the consolidated financial statements.

Variable compensation of the Chief Executive Officer is measured based on the revenue and profitability of the Company as well as success in reaching specific strategic goals.

### Audit Committee, Compensation Committee and Governance and Nomination Committee

Dialog has established an Audit Committee of the Board of Directors. Committee members are appointed by the Board from amongst the non-executive directors of the Company. Members are independent and one of them has to be a financial expert. Committee members are Messrs. Hughes (Chairman of the Audit Committee), Glover, Weber and Tan. The CEO, CFO and a representative of the external auditors normally attend meetings. The committee Chairman reports formally to the Board on its proceedings after each meeting

on all matters within its duties and responsibilities. After each meeting, the committee meets with the board to discuss audit issues without management in attendance.

The Compensation Committee determines the salaries and incentive compensation of Dialog’s officers and the officers of the Company’s subsidiaries and provides recommendations for the salaries and incentive compensation of other employees and consultants. Our Compensation Committee consists of Messrs. McMonigall (Chairman of the Compensation Committee), Glover and Reyes. None of the members of this Committee should serve as an employee of the Company.

Our Governance and Nomination Committee consists of Messrs. Shaw (Chairman of the Nomination Committee), Reyes and Glover and sits with the purpose of seeking to ensure that the Board has directors of the right skills and experience to help guide the Management.

### Transparency, including Director’s dealing, insider dealing and loans

Dialog promptly discloses price sensitive information to the stock exchange and then publishes the information electronically. Significant shareholder interests should be reported to the Company according to the UK Companies Act 2006. Transactions in securities of the Company’s own shares carried out by members of the Board of Directors and their family members will be reported and published without delay pursuant to section 15a of the German Securities Trading Act (Wertpapierhandelsgesetz). With regard to insider dealing Dialog has adopted a Code of Dealing. This sets out guidelines to prevent abuse of price sensitive information by prohibiting dealing in any of the company’s financial instruments during defined periods. In addition, the Company will not provide or guarantee any loans to Directors or senior executives.

### Business conduct and ethics

The Company shall comply with all governmental laws, rules and regulations that are applicable to the Company’s activities and expects that all Directors, officers and employees acting on behalf of the Company will obey the law. Directors, officers and employees should not be involved in any activity which creates or gives the appearance of a conflict of interest between their personal interests and the Company’s interests. The Company is committed to promoting the values

of honesty, integrity and fairness in the conduct of its business and sustaining a work environment that fosters mutual respect, openness and individual integrity. Directors, officers and employees are expected to deal honestly and fairly with the Company's customers, suppliers, competitors and other third parties.

#### Auditor's independence

The aggregate fees billed for each of the last two fiscal years for professional services rendered for the audit of annual financial statements or services by the principal accountants (KPMG then E&Y), were as follows:

(in thousands of €)	2006	2005
Auditors' remuneration		
audit	(170)	(192)
tax fees	-	(60)
	(170)	(252)

The amount in 2006 relates to E&Y; the amount in 2005 relates to KPMG. In 2006 no tax services were rendered by E&Y.

On October 4, 2006 the Company announced the appointment of Ernest & Young as its auditors and the resignation of KPMG in that role with immediate effect. The change of auditors followed a tender process initiated by the Company.

#### Board Meetings

During the year the Board oversaw the functioning of executive management of the Company at the quarterly Board Meetings of February 14, April 20, July 13 and October 18 2006 and assured itself of the proper conduct of executive management during that year. At such Board Meetings the Board received and analyzed reports from the Chief Executive as to the achievements of the Company as compared to budget and progress made in achieving the commercial goals for the year.

In addition, on 5 and 6 December 2006 a two day strategy meeting was held to plan for the future and to discuss the achievements of the Management during that year.

During 2006, Jan Tufvesson, Michael Risman, Roland Pudelko and Tim Anderson resigned as directors and I would like to thank each of them for their many years of valuable contribution to the Company. The board was supplemented by the important appointments of Christopher Burke, Russ Shaw, Peter Tan and Peter Weber.

The Compensation Committee met in February, April and October 2006 to discuss and recommend to the Board employee remuneration, appointments and share option grants. Michael Risman resigned from the Committee in July. John McMonigall succeeded him as Chairman of the Committee

which also includes Greg Reyes and Michael Glover. The Audit Committee, now comprising Aidan Hughes as Chairman and Michael Glover, Peter Weber and Peter Tan, met on a quarterly basis. These meetings concentrated on a review of the financial information to be reported for the relevant prior financial period and on the internationally accepted standards for fair and responsible financial reporting and corporate governance. The Governance and Nomination Committee, now comprising Russ Shaw as Chairman, Greg Reyes and Michael Glover, met twice during the year to consider the issue of new Board appointments.

The Company's audited financial statements for the year ended December 31, 2005, and the reports from the Directors and Auditors thereon were presented to, and approved by, the shareholders at the Annual General Meeting of the Company, held on June 19, 2006, at which KPMG, the Company's independent auditor, was reappointed until the following Annual General Meeting of the Company.

The Board extends its thanks and appreciation to the Executive Management and all employees for their hard work in 2006.

#### Declaration of conformity with regard to the German Corporate Governance Code

"Dialog Semiconductor Plc has established and published its own corporate governance principles corresponding in substance to the provisions of the German "Declaration on Corporate Governance" as published on November 13, 2002 thereby adopting in substance the recommendations of the Government Commission on the German Corporate Governance Code".

This declaration is available on the Internet at: [www.dialog-semiconductor.com/Investor Relations/Corporate Governance](http://www.dialog-semiconductor.com/Investor Relations/Corporate Governance).

London, 10 April 2007

Greg Reyes, Chairman

## Executive Management

### Dr. Jalal Bagherli

#### Chief Executive Officer (51)

Dr. Jalal Bagherli joined Dialog Semiconductor in September 2005 as CEO. Prior to this, he was Vice President & General Manager for the Mobile Multimedia business unit for Broadcom Corporation and the CEO of Alphamosaic. Dr Bagherli has extensive experience of the semiconductor industry with a wealth of knowledge about the Far Eastern, European and North American markets, gained through his previous professional and executive positions with Texas Instruments and Sony. He is also a non executive director of Lime Microsystems Ltd.



### Gary Duncan

#### Vice-President, Engineering (51)

With the Company since 1987, he is responsible for the design and development of semiconductor products. Prior experience includes various senior engineering and management positions at Plessey and ES2.

### Jürgen Friedel

#### General Manager, Automotive and Industrial Business Unit (58)

Joined Dialog Semiconductor in January 1999. He is responsible for the Automotive & Industrial Business Unit. He holds a diploma for communications engineering from the University of applied sciences in Esslingen. Before joining Dialog Semiconductor he held various Senior Management positions at SEL/ITT and National Semiconductor in Germany.





**Peter Hall**

**Vice-President, Operations and Quality (55)**

Joined in 1987 and is responsible for operations and quality. Previous management and engineering positions were at STC Semiconductors and MEM in Switzerland.

**Udo Kratz**

**General Manager, Audio and Power Management Business Unit (44)**

Joined the company in May 2006 and is responsible for the Audio & Power Management Business Unit within Dialog. The products from this business unit cover mobile phone and portable consumer market segments and in the past years have contributed the largest revenue to Dialog. Mr Kratz has 18 years of extensive experience of the semiconductor industry gained through general management, senior marketing and engineering positions at Robert Bosch GmbH, Sony Semiconductor and Infineon Technologies. He holds a degree in electronic engineering.



**Jean-Michel Richard**

**CFO, Vice-President Finance (43)**

Joined Dialog in October 2006 to lead Dialog's finance department. Mr. Richard comes to Dialog after a successful career in key finance and treasury positions at Motorola and ON Semiconductor both in Europe and the USA. His most recent assignment was Finance Director for the Global Manufacturing and Technology division of ON Semiconductor located at Phoenix, Arizona. Mr. Richard holds a Master in Economics from the University Of Geneva, Switzerland.



**Richard Schmitz**

**Vice-President, Advanced Technology (50)**

Joined in 1989 and is responsible for addressing future product development and advanced technology trends as well as other future R&D needs. Previously at Hewlett Packard's instruments division and the Institute for Microelectronics, Stuttgart.

**Manoj Thanigasalam**

**General Manager, Display Systems Business Unit (43)**

Is a physics and electronics graduate and has over 20 years experience in the semiconductor and display industry. Before joining Dialog he was the VP Business development for ZBD Displays a start up focused on novel Bistable LCD displays for electronic label and signage market. Prior to this Manoj spent 6 years as General Manager of marketing for the Digital TV and wireless communication market at Sony Semiconductor. Manoj has also worked in engineering and marketing positions for Texas Instruments, Philips, ARM and LSI Logic.



**Organizational Changes**

Martin Klöble, formerly Vice-President, Finance and Controlling left the company at the end of 2006 to assume a new role in a privately held real estate company. He was replaced by Jean-Michel Richard, CFO and VP of Finance who joined Dialog on 25<sup>th</sup> September 2006.

Bill Caparelli, Vice President, Sales left the Company on 31<sup>st</sup> December 2006 on mutually agreed terms due to the restructuring of our US Sales Organisation.

Toshihiro Watanabe joined the Company in July 2006 as President and representative director of Dialog Semiconductor KK, replacing Masayuki Suzuki.

In March 2006, the Company introduced a new organizational structure. As a result Engineering was unified in a single unit led by Gary Duncan, Vice President, Engineering. Richard Schmitz, previously serving as Vice-President, Engi-

neering – Mixed Signal ICs, now addresses future product development, advanced technology trends and our R&D needs as Vice President of Advanced Technology. The Company also established a Business Unit structure, recruiting Udo Kratz to lead Audio Power Management, Manoj Thanigasalam to lead Display and promoting Juergen Friedel as Automotive and Industrial Business Unit General Manager.

## Board of Directors

### Gregorio Reyes, Chairman (65)

joined us as a director in December 2003. Gregorio has experience primarily in the areas of data storage and magnetic recording, semiconductors and telecommunications. He began his career with National Semiconductor, followed by executive positions with Motorola, Fairchild Semiconductor and Eaton. From 1981 to 1984 he was president and CEO of National Micronetics, a provider of hard disc magnetic recording head products for the data storage industry. Between 1986 and 1990, he was chairman and CEO of American Semiconductor Equipment Technologies. Reyes co-founded Sunward Technologies in 1985 and served as Chairman and CEO until 1994. He is currently serving on the board a director of Seagate Technology. He also serves as a director of several privately held companies: LSI Logic, Nuera Communications, Future Trade Technology, Appshop and Astute Networks.

### Dr. Jalal Bagherli, Chief Executive Officer (51)

joined Dialog Semiconductor in September 2005 as CEO. Prior to this, he was Vice President & General Manager for the Mobile Multimedia business unit for Broadcom Corporation and the CEO of Alphamosaic. Dr Bagherli has extensive experience of the semiconductor industry with a wealth of knowledge about the Far Eastern, European and North American markets, gained through his previous professional and executive positions with Texas Instruments and Sony. He is also a non executive director of Lime Microsystems Ltd.

### Michael John Glover (68)

joined the board of our then-holding company in 1990 and has served as a director since March 1998. Mr. Glover was a senior executive with technology based companies in the United Kingdom, Europe, the Far East and North America prior to becoming involved in private equity fund management in 1985. He has a degree in economics from the University of Birmingham. Mr. Glover is currently Managing Director of Aylestone Strategic Management Limited and serves as a director of other companies.

### Aidan Hughes (46)

joined us as a director in October 2004. He qualified as a chartered accountant with Price Waterhouse in the 1980s before taking senior accountant roles at Lex Service Plc and Carlton Communications Plc. He served the Sage Group Plc as Finance Director from 1993 until 2000. Between December 2001 and August 2004 Mr. Hughes was a director of Communis Plc and is now a director and investor in UK private technology companies.

### John McMonigall (63)

has served as one of our directors since March 1998. He joined Apax Partners as a director in 1990 and is currently the director responsible for investments in telecommunications, software and related fields. Between 1986 and 1990, Mr. McMoni-

gall held a variety of senior positions at British Telecom, including Managing Director of the customer service division. He was also a member of the management board of British Telecom. He is currently on the board of five other public and private companies, including Crane Telecommunications Ltd, Autonomy Plc and Amphion Ltd.

### Peter Weber (61)

joined us on February 1, 2006 bringing to the company 35 years of experience in the semiconductor sector. He has gained his experience of the high-tech industry with a broad range of companies, including Texas Instruments, Intel, Siliconix, the Temic Group and Netro Corporation. During his 35 years in the industry he has held a number of general management and senior marketing roles at these companies, both in Germany and Silicon Valley. Since 1998 he has been an investor and management consultant, serving on the boards of a number of companies in Europe and the US. He holds a MSEE degree in communications engineering.

### Peter Tan (58)

joined us on July 13, 2006. He has held senior management roles across a broad range of technology companies, including Apple Computer, Molex and Flextronics, where he currently serves as President & Managing Director for Asia. Peter has over thirty years experience of operating in the Far East where he has built up a strong base and expertise with world class manufacturing and technology companies.

### Chris Burke (46)

joined us on July 13, 2006. He served as CTO and CIO for Vodafone Limited until the end of 2004. Previously, he was CTO and CIO at Energis. He is a highly experienced director currently holding appointments at Oz, a Vantage Point portfolio company, and Tatar Systems in Boston. He has provided strategic advice to technology companies since 1982, including high growth technology start ups March Networks and Ubiquity Software, as well as sitting on the technical advisory board of Hewlett Packard. Chris brings with him industry wide contacts and knowledge.

### Russ Shaw (44)

joined us on July 13, 2006. He is currently Capability and Innovation Director within O2, focusing on creating a competitive advantage for the business around new products, broadband, online, future CRM, content and convergence. He has been Marketing Director at O2 since 2005, establishing a strong brand and product road map leading to significant customer growth. He has over twenty years senior marketing and brand management experience in the telecoms and financial services arena and brings with him a depth of knowledge having previously held senior level positions with Mobileway and NTL Group as well as American Express and Charles Schwab.

# Glossary

## Technical Glossary

**Analog** A type of signal in an electronic circuit that takes on a continuous range of values rather than only a few discrete values.

**ASIC** Application Specific Integrated Circuit; an integrated chip custom designed for a specific application.

**ASSP** Application Specific Standard Product; a semiconductor device integrated circuit (IC) dedicated to a specific application and sold to more than one user.

**Audio CODEC** The interface between analog signals (such as the human voice) and the digital data processing inside a mobile phone, determining voice quality.

**CAD** Computer Aided Design, usually refers to a software tool used for designing electronics hardware or software systems.

**CDMA** (Code Division Multiple Access) An alternative to GSM technology for mobile wireless networks.

**Chips** Electronic integrated circuits.

**CMOS** Complimentary Metal Oxide Semiconductor, the most popular class of semiconductor manufacturing technology.

**DC-DC** A DC-to-DC converter accepts a direct current input voltage and produces a direct current output voltage. The output is typically at a different voltage level than the input, and often the component provides power bus regulation.

**Digital** A type of signal used to transmit information that has only discrete levels of some parameter (usually voltage).

**Fabless** A term describing a company that designs and delivers semiconductors by outsourcing the fabrication (manufacturing) process.

**Foundry** A manufacturing plant where silicon wafers are produced.

**IC** Integrated Circuit; an electronic device with numerous components on a single chip.

**Imaging** The capture and processing of images via an image sensor for use by an electronic device to send to a display for viewing by a user.

**Liquid Crystal Display (LCD)** A display technology found in many portable electronics products, including personal organizers, cellular handsets and notebook computers.

**LDO** Low Dropout voltage regulators are used in battery operated systems, where the output voltage is typically lower than the input voltage.

**LED** Light Emitting Diode. A semiconductor device that emits light when charged with electricity, often used for LCD display backlights.

**Mixed signal** Describes a combination of analog and digital signals being

generated, controlled or modified on the same chip.

**MLA** Multi-Line Addressing is a technology used in color LCDs to enable full color, high quality display of moving images with fast response time, high brightness, lower cost and low power consumption.

**MP3** (MPEG-1 Audio Layer-3) A standard technology format for compression of sound sequences into very small files, while preserving the original level of sound quality.

**NiMH, L Ion and polymer** Various battery technologies.

**OEM** An Original Equipment Manufacturer is a company that builds products or components that are used in products sold by another company.

**OLED** Organic light emitting diode.

**PDA** Personal digital assistants are handheld devices that were originally designed as personal organizers, but became much more versatile over the years. A basic PDA usually includes date book, address book, task list, memo pad, clock, and calculator software.

**Power management** The management of the power requirements of various subsystems, important in hand-held and portable electronics equipment.

**PMIC** Power Management IC.

**Semiconductor** A base material halfway between a conductor and an insulator, which can be physically altered by mixing in certain atoms. Semiconductors form the basis for present-day electronics.

**Silicon** A semi-metallic element used to create a wafer, and the most common semiconductor material - in about 95% of all manufactured chips.

**Smart Mirror™** A technology patented by Dialog Semiconductor which simplifies circuit design and provides very low current consumption in power management circuits.

**STN** Super-Twisted Nematic, refers to the direction of rotation of the liquid crystals in an LCD to enable excellent brightness and a wide angle at which the display can be viewed before losing much contrast.

**USB** Universal Serial Bus. A universal interface standard to connect different electronics devices

**VGA** Video Graphics Array. A standard size/resolution of 640 pixels by 480 pixels for digital cameras, images, and displays.

**Wafer** A slice of silicon from a 4, 5, 6 or 8 inch diameter silicon bar and used as the foundation on which to build semiconductor products.

**WCDMA** Wideband CDMA, a 3G (third generation) wireless standard, also referred to as UMTS.

## Financial Glossary

**CAGR** Compound Annual Growth Rate is a method of assessing the average growth of a value over time.

**Cash Flow** The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an enterprise during a period. It helps to assess the enterprise's ability to generate positive future net cash flows. A statement of cash flows shall explain the change in cash and cash equivalents during the period by classifying cash receipts and payments according to whether they stem from operating, investing, or financing activities.

**Cash flow from operating activities** Cash flow from operating activities includes all transactions and other events that are not defined as investing or financing activities in paragraphs. Operating activities generally involve producing and delivering goods and providing services. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income.

**Comprehensive Income** The purpose of reporting comprehensive income is to report a measure of all changes in equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with owners such as capital increases or dividends. An example of items effecting comprehensive income is foreign currency translation adjustments resulting from the process of translating an entity's financial statements in a foreign currency into the reporting currency.

**Corporate Governance** Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

**Deferred taxes** Deferred tax assets or liabilities are temporary differences between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively.

**Derivative financial instruments** A financial instrument that derives its value from the price or expected price of an underlying asset (e.g. a security, currency or bond).

**Gross Margin** Gross Margin equals the difference between revenues and cost of sales as presented in the statement of operations.

**Impairment** Impairment is the condition that exists when the carrying amount of a long-lived asset exceeds its fair value (the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset).

**IFRS** (International Financial Reporting Standards) Accounting standards generally to be used for fiscal years commencing on or after January 1, 2005 by all publicly listed European Union companies in compliance with the European Parliament and Council Regulation adopted in July 2002.

**Prime Standard** The new segmentation of the equity market of the German Stock Exchange comprises a Prime Standard segment in addition to the General Standard segment that applies the statutory minimum requirements. The Prime Standard segment addresses companies that wish to target international investors. These companies are required to meet high international transparency criteria, over and above those set out by the General Standard.

**Restructuring Charges** Costs associated with an exit or disposal activity, e.g. termination benefits provided to employees that are involuntarily terminated.

**Securities** Debt securities are instruments representing a creditor relationship with an enterprise and include government securities, corporate bonds, commercial paper, and all securitized debt instruments. Available-for-sale securities are debt securities not classified as held-to-maturity or trading securities.

**Shareholders' equity** Shareholders' equity reflects the investment of shareholders in a company. Shareholders' equity is comprised of ordinary shares, additional paid-in capital, retained earnings and accumulated other comprehensive income.

**Stock option plans** Stock option plans include all agreements by an entity to issue shares of stock or other equity instruments to employees. Stock option plans provide employees the opportunity to receive stock resulting in an additional compensation based on the future share price performance. The purpose of stock option plans is to motivate employees to increase shareholder value on a long-term basis.

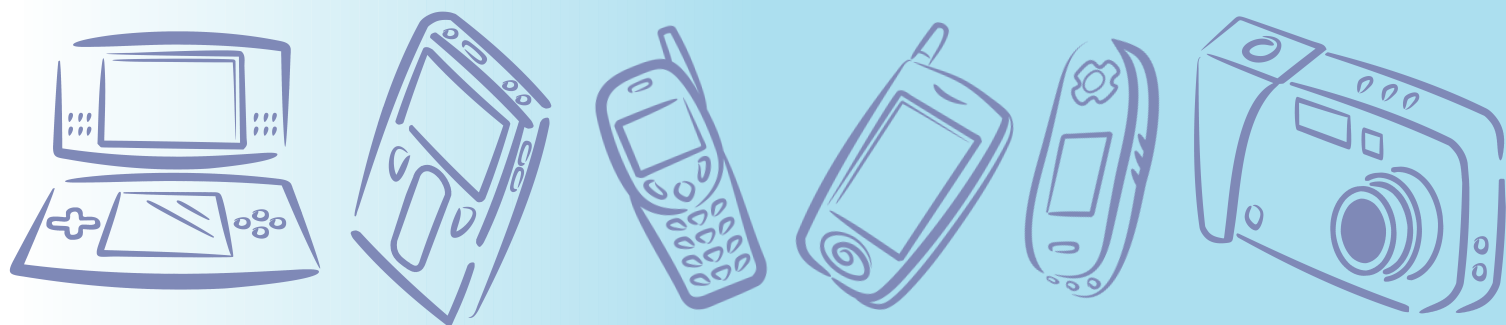
**Total Assets** Total assets include all current and non-current assets. Total assets equal total liabilities and shareholders' equity.

**Working Capital** Working capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business



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