STMICROELECTRONICS NV
Form 6-K
November 09, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

PURSUANT TO RULE 13a-16 or 15d-16 OF

THE SECURITIES EXCHANGE ACT OF 1934

Report on Form 6-K dated November 9, 2005

STMicroelectronics N.V.

(Name of Registrant)

39, Chemin du Champ-des-Filles

1228 Plan-les-Ouates, Geneva, Switzerland

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes No

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes No

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

Enclosure: STMicroelectronics N.V. s Third Quarter 2005:

Operating and Financial Review and Prospects;

Unaudited Interim Consolidated Statements of Income, Balance Sheets, Statements of Cash Flow, and Statements of Changes in Shareholders Equity and related Notes for the three months and nine months ended October 1, 2005; and

Certifications pursuant to Sections 302 (Exhibits 12.1 and 12.2) and 906 (Exhibit 13.1) of the Sarbanes-Oxley Act of 2002, submitted to the Commission on a voluntary basis.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Overview

The following discussion should be read in conjunction with our Unaudited Interim Consolidated Statements of Income, Balance Sheets, Statements of Cash Flows and Statements of Changes in Shareholders Equity for the three months and nine months ended October 1, 2005 and Notes thereto included elsewhere in this Form 6-K and in our annual report on Form 20-F for the year ended December 31, 2004 as filed with the U.S. Securities and Exchange Commission (the Commission or the SEC) on March 23, 2005 (the Form 20-F). The following discussion contain statements of future expectations and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 or Section 21E of the Securities Exchange Act of 1934, each as amended, particularly in the sections Critical Accounting Policies Using Significant Estimates , Business Outlook and Liquidity and Capit Resources Financial Outlook . Our actual results may differ significantly from those projected in the forward-looking statements. For a discussion of factors that might cause future actual results to differ materially from our recent results or those projected in the forward-looking statements in addition to the factors set forth below, see Cautionary Note Regarding Forward-Looking Statements and Item 3. Key Information Risk Factors included in our Form 20-F as they may be updated in our SEC submissions from time to time. We assume no obligation to update the forward-looking statements or such risk factors.

Critical Accounting Policies Using Significant Estimates

The preparation of our Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) requires us to make estimates and assumptions that have a significant impact on the results we report in our consolidated financial statements, which we discuss under the section Results of Operations . Some of our accounting policies require us to make difficult and subjective judgments that can affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. The primary areas that require significant estimates and judgments by management include, but are not limited to, sales returns and allowances; reserves for price protection to certain distributor customers; allowances for doubtful accounts; inventory reserves and normal manufacturing capacity thresholds to determine costs to be capitalized in inventory; accruals for warranty costs; litigation and claims; valuation of acquired intangibles; goodwill; investments and tangible assets as well as the impairment of their related carrying values; restructuring charges; other non-recurring special charges; assumptions used in calculating pension obligations and pro forma share-based compensation; assessment of hedge effectiveness of derivative instruments; deferred income tax assets, including required valuation allowances and liabilities; as well as provisions for specifically identified income tax exposures. We base our estimates and assumptions on historical experience and on various other factors such as market trends and business plans that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. While we regularly evaluate our estimates and assumptions, our actual results may differ materially and adversely from our estimates. To the extent there are material differences between the actual results and these estimates, our future results of operations could be significantly affected.

We believe the following critical accounting policies require us to make significant judgments and estimates in the preparation of our consolidated financial statements:

Revenue recognition. Our policy is to recognize revenues from sales of products to our customers when all of the following conditions have been met: (a) persuasive evidence of an arrangement exists; (b) delivery has occurred; (c) the selling price is fixed or determinable; and (d) collectibility is reasonably assured. This usually occurs at the time of shipment.

Consistent with standard business practice in the semiconductor industry, price protection is granted to distribution customers on their existing inventory of our products to compensate them for declines in market prices. The ultimate decision to authorize a distributor refund remains fully within our control. We accrue a provision for price protection based on a rolling historical price trend computed on a monthly basis as a percentage of gross distributor sales. This historical price trend represents differences in recent months between the invoiced price and the final price to the distributor, adjusted if required, to accommodate a significant move in the current market price. The short outstanding inventory time period, visibility into the standard inventory product pricing (as opposed to certain customized products) and long distributor pricing history have enabled us to reliably estimate price protection provisions at period-end. We record the accrued amounts as a deduction of revenue at the time of the sale. If market conditions differ from our assumptions, this could have an impact on future periods; in particular, if market conditions were to deteriorate, net revenues could be reduced due to higher product returns and price reductions at the time these adjustments occur.

Our customers occasionally return our products for technical reasons. Our standard terms and conditions of sale provide that if we determine that products are non-conforming, we will repair or replace the non-conforming products, or issue a credit or rebate of the purchase price. Quality returns are not related to any technological obsolescence issues and are identified shortly after sale in customer quality control testing. Quality returns are always associated with end-user customers, not with distribution channels. We provide for such returns when they are considered as probable and can be reasonably estimated. We record the accrued amounts as a reduction of revenue.

We do not have insurance against product claims and we record a provision for warranty costs as a charge against cost of sales based on historical trends of warranty costs incurred as a percentage of sales which we have determined to be a reasonable estimate of the probable losses to be incurred for warranty claims in a period. Any potential warranty claims are subject to our determination that we are at fault and liable for damages, and such claims usually must be submitted within a short period following the date of sale. This warranty is given in lieu of all other warranties, conditions or terms expressed or implied by statute or common law. Generally, we limit our liability to the price allocated to the products which gives rise to the claims.

We maintain an allowance for doubtful accounts for potential estimated losses resulting from our customers inability to make required payments. We base our estimates on historical collection trends. Furthermore, we are required to evaluate our customers credit ratings from time to time and take an additional provision for any specific account that we estimate as doubtful. In the first nine months of 2005, we recorded specific provisions of $6 million related to bankrupt customers, in addition to our standard provision of 1% of total receivables based on the estimated historical collection trends. Although we have determined that our most significant customers are creditworthy, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Goodwill and purchased intangible assets. The purchase method of accounting for acquisitions requires extensive use of estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development, which is expensed immediately. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are instead subject to annual impairment tests. The amounts and useful lives assigned to other intangible assets impact future amortization. If the assumptions and estimates used to allocate the purchase price are not correct or if business conditions change, purchase price adjustments or future asset impairment charges could be required. As of October 1, 2005, the value of goodwill amounted to $223 million.

Impairment of goodwill. Goodwill acquired in business combinations is not amortized and is instead subject to an impairment test performed on an annual basis, or more frequently if indicators of impairment exist, in order to assess the recoverability of its carrying value. Goodwill subject to potential impairment is tested at a level of reporting referred to as a reporting unit. We define our reporting units one level below the three semiconductor product groups under the caption *Business Overview* below. This impairment test determines whether the fair value of each reporting unit for which goodwill is allocated is lower than the total carrying amount of relevant net assets allocated to such reporting unit, including its allocated goodwill. If lower, the implied fair value of the reporting unit goodwill is then compared to the carrying value of the goodwill, and an impairment charge is recognized for any excess. In determining the fair value of a reporting unit, we usually estimate the expected discounted future cash flows associated with the reporting unit. Significant management judgments and estimates are used in forecasting the future discounted cash flows, including: the applicable industry s sales volume forecast and selling price evolution, the reporting unit s market penetration, the market acceptance of certain new technologies and relevant cost structure. Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution, our sales expectations and our costs evaluation and are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect, and future adverse changes in market conditions or operating results of acquired businesses not in line with our estimates may require impairment of certain goodwill. For the first nine months as of October 1, 2005, we had an impairment of goodwill of $39 million, which we recorded in the first quarter of 2005.

Intangible assets subject to amortization. Intangible assets subject to amortization include the cost of technologies and licenses purchased from third parties, internally developed software which is capitalized and purchased software. Intangible assets subject to amortization are reflected net of any impairment losses. These are amortized over a period ranging from three to seven years. The carrying value of intangible assets subject to amortization is evaluated whenever changes in circumstances indicate that the carrying amount may not be recoverable. In determining recoverability, we initially assess whether the carrying value exceeds the undiscounted cash flows associated with the intangible assets. If exceeded, we then evaluate whether an impairment charge is required by determining if the asset s carrying value also exceeds its fair value. An impairment loss is recognized for the excess of the carrying amount over the fair value. We normally estimate the fair value based on the projected discounted future cash flows associated with the intangible assets. Significant management judgments and estimates are required and used in the forecasts of future operating results that are used in the discounted cash flow method of valuation, including: the applicable industry s sales volume forecast and selling price evolution, our market penetration, the market acceptance of certain new technologies and costs evaluation. Our evaluations are based on financial plans updated with the latest available projections of the semiconductor market evolution and our sales expectations and are consistent with the plans and estimates that we use to manage our business. It is possible, however, that such plans and estimates may be incorrect and that future adverse changes in market conditions or operating results of businesses acquired may not be in line with our estimates and may therefore require impairment of certain intangible assets. For the first nine months as of October 1, 2005, we have registered an impairment charge of $25 million, out of which $1 million with respect to the third quarter of 2005. As of October 1, 2005, the value of intangible assets subject to amortization amounted to $227 million.

Property, plant and equipment. Our business requires substantial investments in technologically advanced manufacturing facilities, which may become significantly underutilized or obsolete as a result of rapid changes in demand and ongoing technological evolution. We estimate the useful life of our manufacturing equipment, which is the largest component of our long-lived assets, to be six years. This estimate is based on our experience with using equipment over time. Depreciation expense is a major element of our manufacturing cost structure. We begin to depreciate new equipment when it is put into use.

We evaluate each period whether there is reason to suspect that tangible assets or groups of assets might not be recoverable. Factors we consider important which could trigger an impairment review include: significant negative industry trends, significant underutilization of the assets or available evidence of obsolescence of an asset and strategic management decisions impacting production or an indication that its economic performance is, or will be, worse than expected. Since a significant portion of our tangible assets is carried by our European affiliates and their cost of operations are mainly denominated in euros while revenues primarily are denominated in U.S. dollars, the exchange rate dynamics may also trigger impairment charges. In determining the recoverability of assets to be held and used, we initially assess whether the carrying value exceeds the undiscounted cash flows associated with the tangible assets or group of assets. If exceeded, we then evaluate whether an impairment charge is required by determining if the asset s carrying value also exceeds its fair value. We normally estimate this fair value based on independent market appraisals or the sum of discounted future cash flows, using market assumptions such as the utilization of our fabrication facilities and the ability to upgrade such facilities, change in the selling price and the adoption of new technologies. We also evaluate the continued validity of an asset s useful life when impairment indicators are identified. Assets classified as held for disposal are reflected at the lower of their carrying amount or fair value less selling costs and are not depreciated during the selling period. Selling costs include incremental direct costs to transact the sale that we would not have incurred except for the decision to sell.

Our evaluations are based on financial plans updated with the latest projections of the semiconductor market and of our sales expectations, from which we derive the future production needs and loading of our manufacturing facilities, and which are consistent with the plans and estimates that we use to manage our business. These plans are highly variable due to the high volatility of the semiconductor business and therefore are subject to continuous modifications. If the future evolution differs from the basis of our plans, both in terms of market evolution and production allocation to our manufacturing plants, this could require a further review of the carrying amount of our tangible assets resulting in a potential impairment loss.

Inventory. Inventory is stated at the lower of cost or net realizable value. Cost is computed by adjusting standard cost to approximate actual manufacturing costs on a quarterly basis; the cost is therefore dependent on our manufacturing performance. In the case of underutilization of our manufacturing facilities, we estimate the costs associated with the excess capacity; these costs are not included in the valuation of inventories, but charged directly to cost of sales.

The valuation of inventory requires us to estimate obsolete or excess inventory as well as inventory that is not of saleable quality. Provisions for obsolescence are estimated for excess uncommitted inventories based on the previous quarter sales, order backlog and production plans. To the extent that future negative market conditions generate order backlog cancellations and declining sales, or if future conditions are less favorable than the projected revenue assumptions, we could be required to record additional inventory provisions, which would have a negative impact on our gross margin.

Restructuring charges. We have undertaken, and we may continue to undertake, significant restructuring initiatives, which have required us, or may require us in the future, to develop formalized plans for our exiting activities or to dispose of our activities. We recognize the fair value of a liability for costs associated with an exit or disposal activity when a probable liability exists and it can be reasonably estimated. We record estimated charges for non-voluntary termination benefit arrangements such as severance and outplacement costs meeting the criteria for a liability as described above. Given the significance of and the timing of the execution of such activities, the process is complex and involves periodic reviews of estimates made at the time the original decisions were taken. As we operate in a highly cyclical industry, we continue to evaluate business conditions. If broader or new initiatives, which could include production curtailment or closure of other manufacturing facilities, were to be taken, we may be required to incur additional charges as well as to change estimates of amounts previously recorded. The potential impact of these charges could be material and have a material adverse effect on our results of operations or financial condition. In the third quarter of 2005 and in the first nine months of 2005, the amount of restructuring charges and other related closure costs amounted to $11 million and $49 million before taxes, respectively.

Income taxes. We are required to make estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments also occur in the calculation of certain tax assets and liabilities and provisions.

We are required to assess the likelihood of recovery of our deferred tax assets. If recovery is not likely, we are required to record a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable, which would increase our provision for income taxes. Should there be a change in our ability to recover our deferred tax assets or in our estimates of the valuation allowance, or in the tax rates applicable in the various jurisdictions, this could have an impact on our future tax provision in the periods in which these changes could occur.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax audit issues based on our estimate that probable additional taxes will be due. We reverse the liability and recognize a tax benefit during the period if we ultimately determine that the liability is no longer necessary. We record an additional charge in our provision for taxes in the period in which we determine that the recorded tax liability is less than what we expect the ultimate assessment to be.

Patent and other intellectual property litigation or claims. As is the case with many companies in the semiconductor industry, we have from time to time received, and may in the future receive, communications alleging possible infringement of patents and other intellectual property rights of others. Furthermore, we may become involved in costly litigation brought against us regarding patents, mask works, copyrights, trademarks or trade secrets. In the event that the outcome of any litigation would be unfavorable to us, we may be required to take a license to the underlying intellectual property right under economically unfavorable terms and conditions, possibly pay damages for prior use, and/or face an injunction, all of which singly or in the aggregate could have a material adverse effect on our results of operations and ability to compete. We constantly monitor, with the support of our outside attorneys when deemed necessary or advisable, the chances of any such intellectual property claims being successfully asserted. We record a provision when we estimate that the claim could successfully be asserted in a court of law, when the resulting loss is considered probable and in the absence of a valid offset or counterclaim. See Item 3. Key Information Risk Factors We depend on patents to protect our rights to our technology included in our Form 20-F, as may be updated from time to time in our public filings.

We are currently a party to legal proceedings with SanDisk Corporation (SanDisk); see *Other Developments* below. Based on our current assessment, made with support of our outside attorneys, we do not believe that the SanDisk litigation will have a material adverse effect on our financial position, cash flow, or results of operations. In the third quarter of 2005, there was no impact on our financial statements relating to the ScanDisk litigation. However, if we are unsuccessful in resolving these proceedings, or if the outcome of any other litigation or claim were to be unfavorable to us, we may incur monetary damages, or an injunction or exclusion order.

Other claims. We are subject to the possibility of loss contingencies arising in the ordinary course of business. These include, but are not limited to: warranty costs on our products not covered by insurance, breach of contract claims, tax claims and provisions for specifically identified income tax exposures as well as claims for environmental damages. In determining loss contingencies, we consider the likelihood of a loss of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of such loss or liability. An estimated loss is recorded when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We regularly re-evaluate any losses and claims and determine whether they need to be readjusted based on the current information available to us. In the event of litigation that is adversely determined with respect to our interests or in the event we need to change our evaluation of a potential third-party claim based on new evidence or communications, this could have a material adverse effect on our results of operations or financial condition at the time it were to materialize.

Fiscal Year

Our fiscal year starts on January 1, and the first quarter of 2005 ended on April 2, 2005. The second quarter of 2005 ended on July 2, 2005, and the third quarter of 2005 ended on October 1, 2005. The fourth quarter of 2005 will end on December 31, 2005.

Business Overview

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

Effective January 1, 2005, we realigned our product groups to increase market focus and realize the full potential of our products, technologies, sales and marketing channels. Beginning with the first quarter of 2005, we now report our sales and operating income in three segments:

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the Application Specific Product Groups (ASG) segment, comprised of three product groups our Home, Personal and Communication Sector (HPC), our Computer Peripherals Group (CPG) and our Automotive Product Group (APG). Our new HPC Sector is comprised of the telecommunications, audio and digital consumer groups. Our CPG Group covers computer peripherals products, specifically disk drives and printers, and our APG Group now comprises all of our major complex products related to automotive applications;

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

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the Micro, Linear and Discrete Group (MLD) segment, comprised of discrete and standard products plus standard microcontroller and industrial devices (including the programmable systems memories (PSM) division).

Based upon most recently published estimates, in the first nine months and in the third quarter of 2005, semiconductor industry revenues increased by approximately 6% for the TAM and approximately 5% for the SAM compared to the first nine months of 2004 and the third quarter of 2004. On a sequential basis, the third quarter of 2005 registered an increase of approximately 9% for both the TAM and the SAM.

Our first nine months of 2005 revenues were characterized by a significant sales volume increase and more favorable product mix, which did not translate into an equivalent revenue performance due to the persisting negative impact of pricing pressure. As a result, our revenues increased by approximately 1% to $6,493 million in the first nine months of 2005 compared to $6,432 million in the first nine months of 2004. Our year-over-year sales growth was driven primarily by Computer, Automotive and Telecom, while Consumer and Industrial and Other both declined. Our sales trend, however, was below the TAM and SAM growth rate of 6% and 5% respectively, in the first nine months of 2005.

On a year-over-year basis, our third quarter 2005 net revenues slightly increased by approximately 1% to $2,247 million compared to $2,231 million in the third quarter 2004. Several applications experienced year-over-year sales growth, of which Telecom and Computer Peripherals registered strong double-digit sales growth. These year-over-year increases were largely offset by sales declines in Consumer applications and the distribution market. Our revenue increased in the third quarter of 2005, but remained below the TAM and the SAM, which registered increases of approximately 6% and 5%, respectively.

On a sequential basis, in the third quarter of 2005, we achieved a 3.9% increase in net revenues mainly generated by sales volume, which more than offset the persisting decline in average selling prices. Wireless and Computer Peripherals applications were the primary drivers of this improvement, while Consumer applications slightly improved. We expanded sales in several key markets, notably wireless with new design wins across all targeted market segments. Additionally, our effort to expand our key customer base is gaining momentum. Our net revenues performance was firmly within the previously provided guidance, which indicated a sequential variation between 0% and plus 6% compared to sales in the second quarter of 2005. Nevertheless, our sales trend in the third quarter of 2005 was below the TAM and SAM, as both registered an increase of approximately 9%.

In the first nine months of 2005, our effective exchange rate was €1 for $1.30, which reflects current exchange rate levels and the impact of certain hedging contracts, compared to a 2004 exchange rate of €1 for $1.23. For a more detailed discussion of our hedging arrangements and the impact of fluctuations in exchange rates see *Impact of Changes in Exchange Rates* below.

Due primarily to the negative impact of the declining sales prices and our effective U.S. dollar exchange rate, our gross margin dropped to 33.3% in the first nine months of 2005 from 36.9% in the comparable period of 2004. This negative impact was partially balanced by manufacturing and product mix improvements as well as increased sales volume. A similar trend occurred in the year-over-year basis as our gross margin in the third quarter of 2005 dropped to 34.1% compared to 37.9% in the third quarter of 2004.

On a sequential basis, our gross margin increased from 33.0% in the second quarter of 2005 to 34.1% in the third quarter of 2005. This was the result of increased sales volume, improved product mix and manufacturing efficiencies that were partially offset by the negative pricing pressure. Our third quarter result was within the guidance that indicated a gross margin of approximately 34% plus or minus 1 percentage point.

Our total impairment, restructuring charges and other closure costs were significantly higher in the first nine months of 2005 compared to the first nine months of 2004. This increase relates to our 2005 restructuring and reorganization plans. Our manufacturing cost reduction initiatives are moving forward steadily and contributed to the improved results in the quarter. These will become significant drivers of margin improvement after the next nine months as we complete these programs and realize the associated benefits.

Our operating expenses including selling, general and administrative expenses and research and development were also higher in the first nine months of 2005 compared to the first nine months of 2004 due to the significant resources invested in research and development and to the negative impact of our effective U.S. dollar exchange rate and to one-time compensation charges.

The combined impact of these and other factors resulted in operating income of $47 million in the first nine months of 2005, compared to operating income of $473 million in the first nine months of 2004. In the third quarter of 2005, we registered operating income of $102 million compared to $213 million in the third quarter of 2004 and $12 million in the second quarter of 2005.

In the first nine months of 2005, we realized interest income compared to an expense in the prior year. This was a combined result of rising interest rates on our available cash, and the repurchase in 2004 of our 2010 convertible notes thereby reducing our interest expense.

In the first nine months of 2005, our income taxes resulted in a net benefit of $17 million, compared to a $42 million charge in the first nine months of 2004.

In summary, our financial results for the first nine months of 2005, compared to the first nine months of 2004, were negatively impacted by the following factors:

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negative pricing trends due to a persisting overcapacity in the industry, which translated into our average selling prices declining as a pure pricing effect by approximately 7%;

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the impact of our effective U.S. dollar exchange rate against the euro and other currencies, which translated into an increase in our cost of sales and in our operating expenses significantly higher than the favorable impact on our revenues;

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higher impairment, restructuring charges and other related closure costs of $113 million in the first nine months of 2005 compared to $57 million in the first nine months of 2004 due to the restructuring and reorganization activities announced in 2005; and

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the one-time compensation packages and special bonuses to our former CEO and to a limited number of retired senior executives and related charges for a total amount of $24 million recorded in the first quarter of 2005.

Our financial results for the first nine months of 2005 were favorably impacted compared to the first nine months of 2004 by the following factors:

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higher sales volume and favorable product mix in our revenues;

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continuous improvements of our manufacturing performance;

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net interest income; and

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net income tax benefit.

Our third quarter financial performance was in line with our outlook and showed sequential improvements in revenue, gross margin and earnings per share as well as a significant increase in net operating cash flow. The third quarter was also a period of steady progress across our key objectives:

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We had a good level of sequential sales increase in several key markets, led by wireless. The effort to expand our key customer base also continued to gain momentum. In addition, reflecting the importance of the China market and our leading presence there, we created the Greater China region, a new regional organization focused exclusively on this key market.

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On the product front, we continued to gain traction in the acceptance of our new products. From wireless connectivity application-specific standard product solutions to a new wave of high definition digital consumer offerings, we are compiling important design wins, which will help drive sales and margin improvements in 2006 and beyond.

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Finally, our manufacturing cost reduction initiatives are moving forward steadily and contributed to the improved results in the quarter.

In summary, we are in line with our initiatives to improve overall corporate performance. Our efforts are starting to become visible with improvements of our key metrics to date.

These are forward-looking statements that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially; in particular, refer to those known risks and uncertainties described in Cautionary Note on Forward-Looking Statements herein and Item 3. *Key Information Risk Factors* in our Form 20-F as may be updated from time to time in our SEC filings.

Business Outlook

We believe that moderate industry growth will continue into the final quarter of 2005 and into 2006. Within these dynamics, we expect to continue to make solid progress in improving our performance thanks to our ongoing marketing, research and development and cost actions.

Accordingly, we expect that our revenues will increase sequentially in the fourth quarter in the range between 3% and 9%. Our gross margin for the fourth quarter is expected to be about 36% plus or minus 1 percentage point.

This guidance is based on an effective currency exchange rate for the Company of approximately $1.22 = €1, which reflects current exchange rate levels combined with the impact of existing hedging contracts.

These are forward-looking statements that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially; in particular, refer to those known risks and uncertainties described in Cautionary Note on Forward-Looking Statements herein and Item 3. Key Information Risk Factors in our Form 20-F, as may be updated from time to time in our SEC filings.

Other Developments

In January 2005, we decided to reduce our Access technology products for CPE modem products. This decision was intended to eliminate certain low-volume, non-strategic product families whose return in the current environment did not meet internal targets. This decision resulted in a total impairment charge of approximately $64 million in the first nine months of 2005, out of which $61 million related to impairment of intangible assets and goodwill related to the CPE product lines.

On February 28, 2005, we signed an advanced pricing agreement for the period 2001 through 2007 with the United States Internal Revenue Service resulting in a net one-time tax benefit of approximately $10 million in the first nine months of 2005. In the second quarter of 2005, we benefited from a tax credit of $18 million in relation to the application of the ETI (Extraterritorial Income Exclusion) rules in the United States after notification in writing by the local authorities.

At our annual general meeting of shareholders held on March 18, 2005 (the 2005 AGM), our shareholders approved the distribution of a cash dividend of $0.12 per common share in respect to the 2004 financial year, equivalent to the prior year s cash dividend payment, for a total of approximately $107 million that was paid in the second quarter of 2005. In addition, the shareholders approved the appointment of our Supervisory Board and Managing Board members, amendments to our articles of association and to our 2001 Employee Stock Option Plan, as well as a new 2005 Supervisory Board member and a professional stock-based compensation plan, among other resolutions. Our Supervisory Board is composed of Messrs. Gérald Arbola, Matteo del Fante, Tom de Waard, Didier Lombard, Bruno Steve and Antonino Turicchi, who were each appointed for a three-year term, as well as Messrs. Doug Dunn, Francis Gavois and Robert White, who were each appointed for a one-year term. Our Managing Board is composed of Mr. Carlo Bozotti, our President and Chief Executive Officer.

After our annual general meeting of shareholders, the Supervisory Board appointed Mr. Gérald Arbola as Chairman of the Supervisory Board and Mr. Bruno Steve as Vice Chairman, each for a three-year term. In addition, the Supervisory Board appointed Presidents and members to the Strategic Committee, the Audit Committee and the Compensation Committee. Mr. Gérald Arbola was appointed President of the Strategic Committee, and Messrs. Bruno Steve, Antonino Turicchi, Didier Lombard and Robert White were appointed as members. Mr. Tom de Waard was appointed President of the Audit Committee, Messrs. Robert White and Doug Dunn were appointed members and Messrs. Matteo del Fante and Francis Gavois were appointed as observers. Mr. Gérald Arbola was appointed President of the Compensation Committee, and Messrs. Bruno Steve, Antonino Turicchi, Didier Lombard and Tom de Waard were appointed as members.

On October 25, 2005, the Supervisory Board appointed Mr. Tom de Waard as President of the Nominating and Corporate Governance Committee and Messrs. Gérald Arbola, Bruno Steve, Antonino Turicchi and Didier Lombard were appointed as members.

In line with our 2005 AGM shareholders resolutions, we are transitioning our stock-based compensation plans from stock-option grants to non-vested stock awards. Pursuant to the shareholders resolutions adopted by the 2005 AGM, our Supervisory Board, upon the proposal of the Managing Board and recommendation of the Compensation Committee, took the following actions:

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approved the terms and conditions of the 2005 Supervisory Board Stock-Based Compensation Plan for members and professionals;

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amended our 2001 Employee Stock Option Plan with the aim of enhancing our ability to retain key employees and motivate them to shareholder value creation;

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approved the vesting conditions, linked to our future performance and their continued service with us, to apply to non-vested stock awards granted to employees in 2005, the maximum number of which will be four million, within the remaining number of shares authorized for issuance pursuant to the original plan; and

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accelerated the vesting of all of our outstanding stock options in July 2005 aimed at facilitating the transition to new stock compensation policy with no charge to our interim consolidated statements of income.

We intend to use 4.1 million of our shares held by us in treasury (out of the 13.4 million currently available) to cover the four million non-vested stock award grants pursuant to the 2001 Employee Stock Option Plan as well as the granting of up to 100,000 non-vested shares to the sole member of our Managing Board that was also approved by shareholders at the 2005 AGM. Following this decision, the new plan will generate an additional charge in the income statements of the fourth quarter of 2005 and of the first quarter of 2006. This charge will correspond to the compensation expense to be recognized for the non-vested stock awards from the grant date over the vesting period and will take into consideration the probability of the performance achievement.

In the first quarter of 2005, we recorded in our income statement a total charge of $24 million before tax ($20 million after tax) for the compensation packages and special bonuses granted to our former CEO and to a limited number of retired senior executives.

On May 16, 2005, we announced a restructuring plan that cumulated with other already announced initiatives will address approximately 3,000 people of our workforce outside Asia by mid-2006. From these new measures estimated to cost between $100 to $130 million, we anticipate additional savings of $90 million per year, at completion of the plan. On June 8, 2005, we specified our restructuring efforts by announcing the following: our workforce gross reduction in Europe will represent 2,300 jobs of the 3,000 already announced, we will pursue the upgrading of 150-mm production fabs to 200-mm, we will optimize on a global scale our Electrical Wafer Sorting (EWS) activities, harmonize and rationalize our support functions and disengage from certain activities.

Pursuant to the joint venture agreement that we signed in 2004 with Hynix Semiconductor Inc., to build a front-end memory-manufacturing facility in Wuxi City, Jiangsu Province, China, we made during the first nine months of 2005 capital contributions to the joint venture totaling $25 million, of which $17 million were paid in the third quarter. Under the agreement, Hynix Semiconductor Inc., will contribute $500 million for a 67% equity interest and we will contribute $250 million for a 33% equity interest. In addition, we have committed to grant $250 million in long-term financing for the new joint venture guaranteed by a subordinated collateral on the joint venture’s assets.

On June 30, 2005, we sold our interest in Upek Inc., (a spin-off of our former TouchChip business) for $13 million and recorded in the second quarter of 2005 a gain amounting to $6 million. Additionally, on June 30, 2005, we were granted warrants for 2 million shares of Upek Inc., at an exercise price of $0.01 per share. The warrants are not limited in time but can only be exercised subject to certain conditions, such as a change of control or an initial public offering of Upek Inc., with a valuation of the entire company at or over $39 million.

On August 6, 2005, the €442 million aggregate principal amount of 6¾% mandatory exchangeable notes, initially issued by France Telecom in 2002 and exchangeable into our common shares, reached maturity. We were informed that the exchange ratio was 1.25 of our common shares per each €20.92 principal amount of notes, which resulted in the disposal by France Telecom of approximately 26.4 million of our currently existing common shares, representing the totality of the shares held indirectly by France Telecom in our company.

On September 6, 2005, we announced the appointment of two new Corporate Vice Presidents: Mr. Reza Kazerounian was promoted to the position of Corporate Vice President for the North America region and Mr. Marco Cassis was appointed to the position of Corporate Vice President of STMicroelectronics Japan.

On October 17, 2005, we announced the creation of our new 'Greater China' region to focus exclusively on our operations in China, Hong Kong and Taiwan and appointed Mr. Robert Krysiak as Corporate Vice President and General Manager of Greater China.

On October 25, 2005, upon recommendation of its Compensation Committee, our Supervisory Board approved the conditions for the Executive-Vice Presidents and Corporate Vice-Presidents to become eligible for the Company's Executive Pension Plan Scheme, as follows: eight years of seniority as Executive Vice-President or Corporate Vice-President and a maximum pension after 13 years of service in these positions. Under these conditions, an accrual of up to approximately $2 to $4 million will be recorded in the fourth quarter of 2005.

Legal Proceedings

We are currently a party to legal proceedings with SanDisk.

On October 15, 2004, SanDisk filed a complaint against us with the United States International Trade Commission (the ITC) with respect to certain NAND memory products, alleging patent infringement and seeking an order excluding our NAND products from importation into the United States. On November 15, 2004, the ITC instituted an investigation against us in response to the complaint. On October 19, 2005, Administrative Law Judge Paul J. Luckern, in his Initial Determination, ruled that our NAND products do not infringe the asserted SanDisk patent, and that there was no violation of Section 337 of the U.S. Tariff Act of 1930. No impact to our financial statements resulted from this recent decision.

On October 15, 2004, SanDisk also filed a complaint for patent infringement, and declaratory judgment of non-infringement and patent invalidity against us with the United States District Court for the Northern District of California. The complaint alleges that our products infringe a SanDisk U.S. patent and seeks a declaratory judgment that SanDisk does not infringe several of our U.S. patents. By order dated January 4, 2005, the court stayed SanDisk s patent infringement claim pending a final determination in the ITC action discussed above. On January 20, 2005, the court issued an order granting our motion to dismiss the declaratory judgment causes of action. SanDisk has appealed the order to the United States Court of Appeals for the Federal Circuit.

On February 4, 2005, we filed two complaints for patent infringement against SanDisk with the United States District Court for the Eastern District of Texas. The complaints allege that SanDisk products infringe seven of our U.S. patents. On April 22, 2005, SanDisk filed a counterclaim against us alleging that our products infringed two SanDisk patents. We anticipate that the first trial will be held during the first quarter of 2006 and that the second trial will be held during the third quarter of 2006.

On March 28, 2005, SanDisk filed a complaint for declaratory judgment of non-infringement and patent invalidity against us with the United States District Court for the Northern District of California. The complaint seeks a declaratory judgment that SanDisk does not infringe several of our U.S. patents. On April 11, 2005, SanDisk voluntarily dismissed the case.

On October 14, 2005, we filed a complaint against SanDisk and its current CEO Dr. Eli Harari before the Superior Court of California, County of Alameda. The complaint seeks, among other relief, assignment of certain SanDisk patents that resulted from inventive activity on the part of Dr. Harari that took place while he was an employee, officer and/or director of Waferscale Integration, Inc. We are the successor to Waferscale Integration, Inc. by merger.

Results of Operations

Segment Information

We operate in two business areas: Semiconductors and Subsystems.

In the Semiconductors business area, we design, develop, manufacture and market a broad range of products, including discrete, memories and standard commodity components, application-specific integrated circuits (ASICs), full custom devices and semi-custom devices and application-specific standard products (ASSPs) for analog, digital, and mixed-signal applications. In addition, we further participate in the manufacturing value chain of Smart card products through our Incard division, which includes the production and sale of both silicon chips and Smart cards. Our principal investment and resource allocation decisions in the Semiconductor business area are for expenditures on research and development and capital investments in front-end and back-end manufacturing facilities.

In the Semiconductors segment, effective January 1, 2005, we realigned our product groups to increase market focus and realize the full potential of our products, technologies, and sales and marketing channels. Beginning with the first quarter of 2005, we now report our sales and operating income in three segments:

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Application Specific Product Groups (ASG) segment, comprised of three product groups Home, Personal and Communication Sector (HPC), Computer Peripherals Group (CPG) and new Automotive Product Group (APG);

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Memory Products Group (MPG) segment; and

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Micro, Linear and Discrete Group (MLD) segment.

We have restated our results in prior periods for illustrative comparisons of our performance by product group and by period. The segment information of 2004 has been restated using the same principles as the ones used for the current year. Furthermore, the preparation of segment information in accordance with the new organization of the groups, due to the significant changes in the segment structure, requires management to make significant estimates, assumptions and judgments in determining the operating income of the new groups for the prior year, which can affect the reported amounts for 2004.

In the Subsystems business area, we design, develop, manufacture and market subsystems and modules for the telecommunications, automotive and industrial markets including mobile phone accessories, battery chargers, ISDN power supplies and in-vehicle equipment for electronic toll payment. Based on its immateriality to our business as a whole, the Subsystems segment does not meet the requirements for a reportable segment as defined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (FAS 131).

The following tables present our consolidated net revenues and consolidated operating income by semiconductor product segment. For the computation of the Groups internal financial measurements, we use certain internal rules of allocation for the costs not directly chargeable to the Groups, including cost of sales, selling, general and administrative expenses and a significant part of research and development expenses. Additionally, in compliance with our internal policies, certain cost items are not charged to the Groups, including impairment, restructuring charges and other related closure costs, start-up costs of new manufacturing facilities, some strategic and special research and development programs or other corporate-sponsored initiatives, including certain corporate level operating expenses and certain other miscellaneous charges. Starting in the first quarter of 2005, we allocated the start-up costs to expand our marketing and design presence in new developing areas to each Group, and we restated prior year results accordingly.

	Three Months Ended		**Nine Months Ended**	
	October 1, 2005	**September 25, 2004**	**October 1, 2005**	**September 25, 2004**
	(unaudited, in $ millions)			
Net revenues by product groups:				
Application Specific Product Groups	1,263	1,231	3,686	3,572
Micro, Linear and Discrete Group	472	501	1,388	1,408
Memory Product Groups	501	482	1,375	1,401
Others[(1)]	11	17	44	51
Total consolidated net revenues	**2,247**	**2,231**	**6,493**	**6,432**

(1)

Includes revenues from sales of subsystems and other products not allocated to product groups.

	Three Months Ended		**Nine Months Ended**	
	October 1, 2005	**September 25, 2004**	**October 1, 2005**	**September 25, 2004**
	(unaudited, in $ millions)			

Operating income (loss) by product groups:				
Application Specific Product Groups	81	137	218	373
Micro, Linear and Discrete Group	68	134	204	314
Memory Product Groups	(17)	14	(145)	40
Total operating income of product groups	132	285	277	727
Others(1)	(30)	(72)	(230)	(254)
Total consolidated operating income	**102**	**213**	**47**	**473**

(1)

Operating income (loss) of Others includes items such as impairment, restructuring charges and other related closure costs, start-up costs, and other unallocated expenses, such as: strategic or special research and development programs, certain corporate-level operating expenses, certain patent claims and litigations, and other costs that are not allocated to the product groups, as well as operating earnings or losses of the Subsystems and Other Products Group. Certain costs, mainly R&D, formerly in the Others category, have been allocated to the groups; thus, the comparable amounts reported in this category in prior period reports may not be the same, while prior periods are reclassified accordingly in the above table.

	Three Months Ended		Nine Months Ended	
	October 1, 2005	**September 25, 2004**	**October 1, 2005**	**September 25, 2004**
	(unaudited)			
	(as a percentage of net revenues)			
Operating income (loss) by product groups:				
Application Specific Product Groups(1)	6.4%	11.1%	5.9%	10.4%
Micro, Linear and Discrete Group(1)	14.4	26.7	14.7	22.3
Memory Product Groups(1)	(3.4)	2.9	(10.5)	2.9
Others(2)	(1.3)	(3.2)	(3.5)	(3.9)
Total consolidated operating income(3)	**4.5%**	**9.6%**	**0.7%**	**7.4%**

(1)

As a percentage of net revenues per product group.

(2)

As a percentage of total net revenues. Operating income (loss) of Others includes items such as impairment, restructuring charges and other related closure costs, start-up costs, and other unallocated expenses, such as: strategic or special research and development programs, certain corporate-level operating expenses, certain patent claims and litigations, and other costs that are not allocated to the product groups, as well as operating earnings or losses of the Subsystems and Other Products Group. Certain costs, mainly R&D, formerly in the Others category, have been allocated to the groups; thus, the comparable amounts reported in this category in prior period reports may not be the same, while prior periods are reclassified accordingly in the above table.

(3)

As a percentage of total net revenues.

	Three Months Ended	Nine Months Ended

	October 1, 2005	September 25, 2004	October 1, 2005	September 25, 2004
	(unaudited, in $ millions)			
Reconciliation to consolidated operating income:				
Total operating income of product groups	132	285	277	727
Strategic and other research and development programs	(10)	(35)	(38)	(89)
Start-up costs	(12)	(13)	(46)	(45)
Impairment, restructuring charges and other related closure costs	(13)	(12)	(113)	(57)
One-time compensation and special contributions(1)	-	-	(22)	-
Loss on foreign exchange	-	(2)	(9)	(6)
Other non-allocated provisions(2)	5	(10)	(2)	(57)
Others(3)	(30)	(72)	(230)	(254)
Total consolidated operating income	**102**	**213**	**47**	**473**

(1)

The total charge for one-time compensation and special contributions was $24 million, of which $2 million was allocated to product groups. The remaining $22 million was not allocated to product groups.

(2)

Includes unallocated income and expenses such as certain corporate level operating expenses and other costs that are not allocated to the product groups.

(3)

Operating income (loss) of Others includes items such as impairment, restructuring charges and other related closure costs, start-up costs, and other unallocated expenses, such as: strategic or special research and development programs, certain corporate-level operating expenses, certain patent claims and litigations, and other costs that are not allocated to the product groups, as well as operating earnings or losses of the Subsystems and Other Products Group. Certain costs, mainly R&D, formerly in the Others category, have been allocated to the groups; thus, the comparable amounts reported in this category in prior period reports may not be the same, while prior periods are reclassified accordingly in the above table.

Net revenues by location of order shipment and by market segment application

The tables below set forth information on our net revenues by location of order shipment and as a percentage of net revenues:

	Three Months Ended		Nine Months Ended	
	October 1, 2005	**September 25, 2004**	**October 1, 2005**	**September 25, 2004**
	(unaudited, in $ millions)			
Net Revenues by Location of Order Shipment[1]				
Europe [2]	680	711	2,060	2,036
North America	269	311	856	932
Asia/Pacific	1,071	939	2,920	2,716
Japan	79	105	226	293
Emerging Markets [2]	148	165	431	455
Total	**2,247**	**2,231**	**6,493**	**6,432**
	(unaudited)			
	(as a percentage of net revenues)			
Net Revenues by Location of Order Shipment[1]				
Europe [2]	30.2%	31.8%	31.7%	31.6%
North America	12.0	14.0	13.2	14.5
Asia/Pacific	47.7	42.1	45.0	42.2
Japan				