

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001.

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number **0-25236**

**MICREL, INCORPORATED**

(Exact name of Registrant as specified in its charter)

California  
(State or other jurisdiction of  
incorporation or organization)

94-2526744  
(I.R.S. Employer Identification No.)

2180 Fortune Drive, San Jose, CA 95131  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (408) 944-0800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

As of April 30, 2001 there were 85,920,640 shares of common stock, no par value, outstanding.

**MICREL, INCORPORATED**  
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**REPORT ON FORM 10-Q**  
**FOR QUARTER ENDED MARCH 31, 2001**

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**ITEM 1. FINANCIAL STATEMENTS**

**MICREL, INCORPORATED**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share amounts)

	<u>March 31,</u> <u>2001</u> (Unaudited)	<u>December 31,</u> <u>2000 (1)</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 123,151	\$ 81,902
Short-term investments	7,121	32,858
Accounts receivable, net	48,254	58,751
Inventories	24,930	20,703
Other current assets	2,298	1,494
Deferred income taxes	<u>20,962</u>	<u>20,485</u>
Total current assets	226,716	216,193
EQUIPMENT AND LEASEHOLD IMPROVEMENTS, NET	116,462	110,576
INTANGIBLE ASSETS, NET	5,233	5,775
OTHER ASSETS	<u>391</u>	<u>350</u>
<b>TOTAL</b>	<u><u>\$ 348,802</u></u>	<u><u>\$ 332,894</u></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 12,918	\$ 14,515
Income taxes payable	13,190	11,720
Deferred income on shipments to distributors	14,410	14,224
Other current liabilities	13,279	12,013
Current portion of long-term debt	<u>5,046</u>	<u>5,429</u>
Total current liabilities	58,843	57,901
LONG-TERM DEBT	4,404	5,327
OTHER LONG-TERM OBLIGATIONS	3,766	3,841
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, no par value - authorized: 5,000,000 shares; issued and outstanding: none	--	--
Common stock, no par value - authorized: 250,000,000 shares; issued and outstanding: 2001 - 85,917,476; 2000 - 85,374,400	95,833	90,854
Accumulated other comprehensive loss	(25)	(32)
Retained earnings	<u>185,981</u>	<u>175,003</u>
Total shareholders' equity	<u>281,789</u>	<u>265,825</u>
<b>TOTAL</b>	<u><u>\$ 348,802</u></u>	<u><u>\$ 332,894</u></u>

(1) Derived from the December 31, 2000 audited balance sheet included in the 2000 Annual Report on Form 10-K of Micrel, Incorporated

See notes to condensed consolidated financial statements.

**MICREL, INCORPORATED**

**CONDENSED CONSOLIDATED INCOME STATEMENTS**

**(Unaudited)**

(In thousands, except per share amounts)

	<b>Three Months Ended March 31,</b>	
	<b><u>2001</u></b>	<b><u>2000</u></b>
NET REVENUES	\$ 64,855	\$ 67,313
COST OF REVENUES	<u>28,877</u>	<u>29,145</u>
GROSS PROFIT	<u>35,978</u>	<u>38,168</u>
OPERATING EXPENSES:		
Research and development	10,797	8,230
Selling, general and administrative	<u>10,069</u>	<u>9,306</u>
Total operating expenses	<u>20,866</u>	<u>17,536</u>
INCOME FROM OPERATIONS	15,112	20,632
OTHER INCOME, NET	<u>1,648</u>	<u>612</u>
INCOME BEFORE INCOME TAXES	16,760	21,244
PROVISION FOR INCOME TAXES	<u>5,782</u>	<u>7,010</u>
NET INCOME	<u><u>\$ 10,978</u></u>	<u><u>\$ 14,234</u></u>
NET INCOME PER SHARE:		
Basic	<u><u>\$ 0.13</u></u>	<u><u>\$ 0.17</u></u>
Diluted	<u><u>\$ 0.12</u></u>	<u><u>\$ 0.15</u></u>
SHARES USED IN COMPUTING PER SHARE AMOUNTS:		
Basic	<u><u>85,657</u></u>	<u><u>83,206</u></u>
Diluted	<u><u>93,962</u></u>	<u><u>94,264</u></u>

See notes to condensed consolidated financial statements.

**MICREL, INCORPORATED**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(In thousands)

	<b>Three Months Ended March 31,</b>	
	<b><u>2001</u></b>	<b><u>2000</u></b>
<b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>	\$ 25,624	\$ 17,947
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of equipment and leasehold improvements	(12,450)	(10,942)
Purchases of short-term investments	(2,756)	(38,816)
Proceeds from sales and maturities of short-term investments	<u>28,500</u>	<u>27,640</u>
Net cash provided by (used in) investing activities	<u>13,294</u>	<u>(22,118)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayments of long-term debt	(1,306)	(1,267)
Proceeds from the issuance of common stock, net	<u>3,637</u>	<u>3,767</u>
Net cash provided by financing activities	<u>2,331</u>	<u>2,500</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	41,249	(1,671)
<b>CASH AND CASH EQUIVALENTS - Beginning of period</b>	<u>81,902</u>	<u>15,360</u>
<b>CASH AND CASH EQUIVALENTS - End of period</b>	<u><u>\$ 123,151</u></u>	<u><u>\$ 13,689</u></u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid for interest	<u>\$ 203</u>	<u>\$ 284</u>
Cash paid for income taxes	<u><u>\$ 3,323</u></u>	<u><u>\$ 5,230</u></u>

See notes to condensed consolidated financial statements.

**MICREL, INCORPORATED**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. SIGNIFICANT ACCOUNTING POLICIES**

**Interim Financial Information** - The accompanying condensed consolidated financial statements of Micrel, Incorporated and its wholly-owned subsidiaries ("Micrel" or the "Company") as of March 31, 2001 and for the quarter ended March 31, 2001 and 2000 are unaudited. In the opinion of management, the condensed consolidated financial statements include all adjustments (consisting only of normal recurring accruals) that management considers necessary for a fair presentation of its financial position, operating results and cash flows for the interim periods presented. Operating results and cash flows for interim periods are not necessarily indicative of results for the entire year.

This financial data should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

**Net Income per Common and Equivalent Share** - Basic net income per share is computed by dividing net income by the number of weighted average common shares outstanding. Diluted net income per share reflects potential dilution from outstanding stock options using the treasury stock method. In June 2000, the Company declared a two-for-one stock split of its common stock in the form of a 100% stock dividend payable June 27, 2000, on all shares of common stock outstanding as of June 6, 2000. All share and per share information in the accompanying condensed consolidated financial statements has been adjusted to retroactively give effect to the stock split for all periods presented.

Reconciliation of weighted average shares used in computing net income per share is as follows (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2001</b>	<b>2000</b>
Weighted average common shares outstanding	85,657	83,206
Dilutive effect of stock options outstanding using the treasury stock method	8,305	11,058
Shares used in computing diluted net income per share	<u>93,962</u>	<u>94,264</u>

**2. INVENTORIES**

Inventories consist of the following (in thousands):

	<b>March 31, 2001</b>	<b>December 31, 2000</b>
Finished goods	\$ 9,375	\$ 6,661
Work in process	13,241	12,027
Raw materials	2,314	2,014
	<u>\$ 24,930</u>	<u>\$ 20,703</u>

**MICREL, INCORPORATED**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**3. BORROWING ARRANGEMENTS**

Borrowing agreements consisted of (i) \$5 million under a revolving line of credit, of which all was unused and available at March 31, 2001, and (ii) \$40 million under a non-revolving line of credit, of which \$38 million was unused and available at March 31, 2001. The two lines of credit are covered by the same loan and security agreement. The revolving line of credit portion of the agreement expires on May 31, 2001 subject to automatic renewal on a month-to-month basis thereafter unless terminated by either party upon 30 days notice. The non-revolving line of credit portion of the agreement which had an expiration date of April 30, 2001 has been extended to May 31, 2001 and the amount has been reduced to \$10 million. The Company expects to amend the non-revolving credit facility to extend the maturity to April 2002. Borrowings under the revolving line of credit bear interest rates of, at the Company's election, the prime rate (8.0% at March 31, 2001), or the bank's revolving offshore rate, which approximates LIBOR (4.88% at March 31, 2001) plus 2.0%. Borrowings under the non-revolving line of credit bear interest rates of, at the Company's election, the prime rate (8.0% at March 31, 2001), the bank's non-revolving offshore rate, which approximates LIBOR (4.88% at March 31, 2001) plus 2.13%, a fixed rate based on the four-year U.S. Treasury Bill rate (4.48% at March 31, 2001) plus 2.75% or an annual adjustable rate based on the one-year U.S. Treasury Bill rate (4.17% at March 31, 2001) plus 2.75%. The agreement contains certain restrictive covenants that include a restriction on the declaration and payment of dividends without the lender's consent. The Company was in compliance with all such covenants at March 31, 2001.

The non-revolving bank line of credit that is covered by the loan agreement described above, can be used to fund purchases of capital equipment whereby the Company may borrow up to 100% of the acquisition cost. Amounts borrowed under this credit line are automatically converted to four-year term notes. All equipment notes are collateralized by substantially all of the Company's manufacturing equipment.

**4. SIGNIFICANT CUSTOMERS**

During the quarter ended March 31, 2001, one customer accounted for \$7.4 million (11.4%) of net revenues. During the quarter ended March 31, 2000, three customers accounted for \$9.1 million (13.5%), \$8.3 million (12.3%) and \$7.7 million (11.4%) of net revenues, respectively.

**5. COMPREHENSIVE INCOME**

Comprehensive income, which was comprised of the Company's net income for the periods and changes in unrealized gains or losses on investments, was \$11.0 million and \$14.2 million for the quarter ended March 31, 2001 and 2000, respectively.

**6. SEGMENT REPORTING**

In 1998, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. The Company operates under two reportable segments, standard products and custom and foundry products.

**MICREL, INCORPORATED**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**Net Revenues by Segment**  
(Dollars in thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2001</b>	<b>2000</b>
<b>Net Revenues:</b>		
Standard Products	\$ 53,031	\$ 48,701
Custom and Foundry Products	11,824	18,612
Total net revenues	<u>\$ 64,855</u>	<u>\$ 67,313</u>
<b>As a Percentage of Total Net Revenues:</b>		
Standard Products	82%	72%
Custom and Foundry Products	18	28
Total net revenues	<u>100%</u>	<u>100%</u>

**7. RECENTLY ISSUED ACCOUNTING STANDARDS**

Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", is effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company has adopted SFAS 133 effective January 1, 2001. Management has concluded that the adoption of SFAS 133 had no material effect on the financial position, results of operations, or cash flows of the Company.

**8. SUBSEQUENT EVENT**

On May 4, 2001, the Company announced that it has reached an agreement to acquire Kendin Communications Inc., a fabless semiconductor company that designs, develops and markets high performance integrated circuits for the communications and networking markets. In connection with the acquisition, the Company will issue approximately 6.2 million shares of its common stock in exchange for all the outstanding Kendin securities and options to purchase securities. Based on the closing price of Micrel stock on May 3, 2001, the implied transaction value is approximately \$215 million. The transaction is expected to be completed in the quarter ending June 30, 2001, subject to customary regulatory approvals, and is intended to be accounted for as a pooling of interests. If the acquisition is completed in the quarter ending June 30, 2001, the Company expects to record in that quarter one-time acquisition charges in the range of \$8 million to \$10 million.



## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Overview**

Micrel designs, develops, manufactures and markets a range of high performance standard analog, high-speed mixed-signal and digital integrated circuits. These circuits are used in a wide variety of electronics products, including those in the high bandwidth communications, computer, telecommunications and industrial markets. In addition to standard products, the Company manufactures custom analog and mixed-signal circuits and provides wafer foundry services.

The Company derives a substantial portion of its net revenues from standard products. Standard products sales represented 82% of net revenues for the quarter ended March 31, 2001 as compared to 72% for the similar period in the prior year. The Company believes that a substantial portion of its net revenues in the future will depend upon standard products sales, although such sales as a proportion of net revenues may vary as the Company adjusts product output levels to correspond with varying economic conditions and demand levels in the markets which it serves. The standard products business is characterized by short-term orders and shipment schedules, and customer orders typically can be canceled or rescheduled without significant penalty to the customer. Since most standard products backlog is cancelable without significant penalty, the Company typically plans its production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. In addition, the Company is limited in its ability to reduce costs quickly in response to any revenue shortfalls.

The Company may experience significant fluctuations in its results of operations. Factors that affect the Company's results of operations include the volume and timing of orders received, changes in the mix of products sold, the utilization level of manufacturing capacity, competitive pricing pressures and the successful development of new products. These and other factors are described in further detail later in this discussion. As a result of the foregoing or other factors, there can be no assurance that the Company will not experience material fluctuations in future operating results on a quarterly or annual basis, which could materially and adversely affect the Company's business, financial condition, results of operations or cash flows.

On May 4, 2001, the Company announced that it has reached an agreement to acquire Kendin Communications Inc., a fabless semiconductor company that designs, develops and markets high performance integrated circuits for the communications and networking markets. In connection with the acquisition, the Company will issue approximately 6.2 million shares of its common stock in exchange for all the outstanding Kendin securities and options to purchase securities. Based on the closing price of Micrel stock on May 3, 2001, the implied transaction value is approximately \$215 million. The transaction is expected to be completed in the quarter ending June 30, 2001, subject to customary regulatory approvals, and is intended to be accounted for as a pooling of interests. There can be no assurance, however, that the acquisition will be completed in that quarter or at all. If the acquisition is completed in the quarter ending June 30, 2001, the Company expects to record in that quarter one-time acquisition charges in the range of \$8 million to \$10 million.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

## Results of Operations

The following table sets forth certain operating data as a percentage of total net revenues for the periods indicated:

	Three Months Ended March 31,	
	2001	2000
Net revenues	100.0%	100.0%
Cost of revenues	44.5	43.3
Gross profit	55.5	56.7
Operating expenses:		
Research and development	16.7	12.2
Selling, general and administrative	15.5	13.8
Total operating expenses	32.2	26.0
Income from operations	23.3	30.7
Other income (loss), net	2.5	0.9
Income before income taxes	25.8	31.6
Provision for income taxes	8.9	10.5
Net income	16.9%	21.1%

*Net Revenues.* Net revenues decreased 4% to \$64.9 million for the quarter ended March 31, 2001 from \$67.3 million for the same period in 2000. This decrease was due to a decrease in custom and foundry products revenues, which was partially offset by increased revenues from standard products. Standard products revenues increased 9% to \$53.1 million representing 82% of net revenues for the quarter ended March 31, 2001 from \$48.7 million or 72% of net revenues for the quarter ended March 31, 2000. Such increases resulted from increased unit shipments. Sales of standard products by the Company during the quarter were led by low dropout regulators, high bandwidth communications products and computer peripheral products. Such products were sold to manufacturers within the computer, high bandwidth communications, telecommunications, and industrial markets. Custom and foundry products revenues decreased 36% to \$11.8 million representing 18% of net revenues for the quarter ended March 31, 2001 from \$18.6 million or 28% of net revenues for the comparable period in 2000. Such decreases were due primarily to decreased unit shipments of custom high speed communications products.

Increasing overall end customer demand during the first half of 2000 resulted in capacity constraints and increasing order lead times for semiconductor suppliers. Longer lead times and concern about availability of semiconductor components, resulted in increased order rates for standard products during the first three quarters of 2000, resulting in increased order backlog. Orders from OEM customers and contract manufacturers serving the high speed communications market were especially strong in the first nine months of 2000 as these customers attempted to secure semiconductor components to meet their projected end demand. However, the supply of semiconductors can quickly and unexpectedly match or exceed demand because customer end demand can change very quickly and, semiconductor suppliers can rapidly increase production output. This can lead to a sudden oversupply situation and a subsequent reduction in order rates as customers adjust their inventories to true demand rates. Customers continuously adjust their inventories resulting in frequent changes in demand for the Company's products.

The semiconductor industry experienced such a change in the supply and demand situation during 2000 and the first quarter of 2001. In the fourth quarter of 2000 and the first quarter of 2001, customers in the high speed communications end market, and the contract manufacturing firms that serve this market, adjusted their demand on component suppliers as they coped with high levels of inventory and sharply reduced demand for their end products. In addition, the slowing of global economic growth in the North American economy during the first quarter of 2001 led to lower order rates from customers serving the computer and industrial end markets as they adjusted to lower demand for their products. The rapid build up of semiconductor inventories in global sales

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

channels caused lead times for components to fall significantly during the first quarter. Due to the combination of excess supply, reduced demand and lower lead times, new orders rates declined and a significant amount of previously placed orders were cancelled during the first quarter of 2001. The corresponding reduction in backlog has left Micrel, like most semiconductor suppliers, with extremely limited visibility into future customer demand. Customers appear to be placing orders on an "as needed" basis due to short supplier lead times combined with the uncertain macroeconomic outlook. The low backlog and uncertainty of customer demand significantly limits the Company's ability to predict future levels of sales and profitability.

International sales represented 43% and 42% of net revenues for the quarters ended March 31, 2001 and 2000, respectively. On a dollar basis, international sales decreased 1% to \$28.1 million for the quarter ended March 31, 2001 from \$28.4 million for the comparable period in 2000. The dollar basis decrease in international sales resulted from decreased shipments to manufacturers of personal computers and communications products primarily in Asia and Europe.

The Company's international sales are denominated in U.S. currency. Consequently, changes in exchange rates that strengthen the U.S. dollar could increase the price in local currencies of the Company's products in foreign markets and make the Company's products relatively more expensive than competitors' products that are denominated in local currencies, leading to a reduction in sales or profitability in those foreign markets. The Company has not taken any protective measures against exchange rate fluctuations, such as purchasing hedging instruments with respect to such fluctuations.

The Company defers recognition of revenue derived from sales to domestic, Canadian, and certain other international distributors until such distributors resell the Company's products to their customers. Sales to stocking representatives and O.E.M. customers are recognized upon shipment. The Company estimates returns and warranty costs and provides an allowance as revenue is recognized.

*Gross Profit.* Gross profit is affected by a variety of factors including the volume of product sales, product mix, manufacturing utilization, product yields and average selling prices. The Company's gross margin decreased to 56% for the quarter ended March 31, 2001 from 57% for the comparable period in the prior year. The decrease in gross margin primarily reflected a greater mix of lower margin products combined with decreased capacity utilization compared to the same period in 2000.

Manufacturing yields, which affect gross margin, may from time to time decline because the fabrication of integrated circuits is a highly complex and precise process. Factors such as minute impurities and difficulties in the fabrication process can cause a substantial percentage of wafers to be rejected or numerous die on each wafer to be nonfunctional. There can be no assurance that the Company in general will be able to maintain acceptable manufacturing yields in the future.

*Research and Development Expenses.* Research and development expenses include costs associated with the development of new processes and the definition, design and development of new products. The Company also expenses prototype wafers and new production mask sets related to new products as research and development costs until products based on new designs are fully characterized by the Company and are demonstrated to support published data sheets and satisfy reliability tests.

As a percentage of net revenues, research and development expenses represented 17% and 12% for the quarters ended March 31, 2001 and 2000, respectively. On a dollar basis, research and development expenses increased \$2.6 million or 31% to \$10.8 million for the quarter ended March 31, 2001 from \$8.2 million for the comparable period in 2000. The dollar increase was primarily due to increased engineering staffing costs and increased prototype fabrication and new process development costs. The Company believes that the development and introduction of new products is critical to its future success and expects to continue its investment in research and development activities in the future.

*Selling, General and Administrative Expenses.* As a percentage of net revenues, selling, general and administrative expenses represented 32% and 26% for the quarters ended March 31, 2001 and 2000, respectively. On a dollar

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

basis, selling, general and administrative expenses increased \$763,000 or 8% to \$10.1 million for the quarter ended March 31, 2001 from \$9.3 million for the comparable period in 2000. The dollar increase was principally attributable to increased costs associated with legal matters and to a lesser extent increased staffing costs, which were partially offset by decreased sales commissions costs.

*Other Income, Net.* Other income, net reflects interest income from investments in short-term investment grade securities offset by interest expense incurred on term notes. Other income, net increased \$1.0 million to a net income of \$1.6 million for the quarter ended March 31, 2001 from a net income of \$612,000 for the comparable period in 2000. The increase was primarily due to an increase in average cash and investment balances combined with a reduction in average term note balances.

*Provision for Income Taxes.* For the quarters ended March 31, 2001 and 2000, the provision for income taxes was 34.5% and 33.0% of income before taxes, respectively. The income tax provision for such interim periods reflects the Company's estimated annual income tax rate.

### Liquidity and Capital Resources

Since inception, the Company's principal sources of funding have been its cash from operations, bank borrowings and sales of common stock. Principal sources of liquidity at March 31, 2001 consisted of cash and short-term investments of \$130 million and bank borrowing arrangements. Borrowing agreements consisted of (i) \$5 million under a revolving line of credit, of which all was unused and available at March 31, 2001, and (ii) \$40 million under a non-revolving line of credit, of which \$38 million was unused and available at March 31, 2001. The two lines of credit are covered by the same loan and security agreement. The revolving line of credit portion of the agreement expires on May 31, 2001 subject to automatic renewal on a month-to-month basis thereafter unless terminated by either party upon 30 days notice. The non-revolving line of credit portion of the agreement which had an expiration date of April 30, 2001 has been extended to May 31, 2001 and the amount has been reduced to \$10 million. The Company expects to amend the non-revolving credit facility to extend the maturity to April 2002. The agreement contains certain restrictive covenants that include a restriction on the declaration and payment of dividends without the lender's consent. The Company was in compliance with all such covenants at March 31, 2001.

The non-revolving bank line of credit that is covered by the loan agreement described above, can be used to fund purchases of capital equipment whereby the Company may borrow up to 100% of the acquisition cost. Amounts borrowed under this credit line are automatically converted to four-year installment notes. All equipment notes are collateralized by substantially all of the Company's manufacturing equipment.

As of March 31, 2001, the Company had \$9.4 million outstanding under term notes that are collateralized by the Company's manufacturing equipment.

The Company's working capital increased by \$9.6 million to \$167.9 million as of March 31, 2001 from \$158.3 million as of December 31, 2000. The increase was primarily attributable to a \$15.5 million increase in cash, cash equivalents and short-term investments, and a \$4.2 million increase in inventories, which were partially offset by a \$10.5 million decrease in accounts receivable.

The Company's cash flows from operating activities increased to \$25.6 million for the quarter ended March 31, 2001 from \$17.9 million for the comparable period in the prior year. The cash flows from operating activities generated by the Company in the quarter ended March 31, 2001 were primarily attributable to net income of \$17.5 million after adding back non-cash activities combined with a decrease in accounts receivable of \$10.5 million, which were partially offset by an increase in inventories of \$4.2 million.

The Company's investing activities during the quarter ended March 31, 2001 provided cash of \$13.3 million as compared to \$22.1 million of cash used for investing activities during the comparable period in the prior year. Cash provided by investing activities during the quarter ended March 31, 2001 resulted from net sales of short-term investments of \$25.7 million, which was partially offset by net purchases of property, plant and equipment of \$12.5 million primarily for wafer fab and testing equipment and leasehold improvements.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

The Company's financing activities during the quarter ended March 31, 2001 provided cash of \$2.3 million as compared to cash provided of \$2.5 million during the comparable period in the prior year. Cash provided by financing activities during the quarter ended March 31, 2001 was the result of \$3.6 million in proceeds from the issuance of common stock through the exercise of employee stock options, which was partially offset by \$1.3 million in repayments of long-term debt.

The Company currently intends to reduce its capital equipment purchases from the year 2000 levels by 30% to 40% to approximately \$35 million to \$45 million during 2001. The Company expects to purchase primarily additional wafer and test manufacturing equipment and leasehold improvements. The Company expects that its cash requirements through 2001 will be met by its cash from operations, existing cash balances and short-term investments, and its credit facilities.

### **Factors That May Affect Operating Results**

All statements contained in this Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the Company's expectations, hopes, intentions, beliefs or strategies regarding the future. Forward-looking statements in this Report on Form 10-Q include, without limitation statements regarding: the Company's future products or product developments; the Company's pending acquisition of Kendin Communications, the expected closing date and accounting treatment of that acquisition and expected acquisition related charges; future research and development spending and the Company's product development strategy; levels of international sales; future expansion or utilization of manufacturing capacity; future expenditures; the composition of the Company's net revenues; fluctuations in results of operations; semiconductor supply and demand; declines in manufacturing yields; the Company's intentions and expectations regarding capital equipment purchases and cash requirements; the defense and outcome of present and future litigation claims; current or future acquisitions. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could differ materially from those in such forward-looking statements. Some of the factors that could cause actual results to differ materially from the results set forth in or implied by such forward looking statements are set forth below. Additional factors that may affect these forward looking statements and the Company's operating results are contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

### **Our operating results may fluctuate because of a number of factors, many of which are beyond our control.**

If our operating results are below the expectations of public market analysts or investors, then the market price of our common stock could decline. Some of the factors that affect our quarterly and annual results, but which are difficult to control or predict are:

- the volume and timing of orders received
  - changes in the mix of products sold
  - market acceptance of our products and our customers' products
  - competitive pricing pressures
  - our ability to introduce new products on a timely basis
  - the timing of new product announcements and introductions by us or our competitors
  - the timing and extent of research and development expenses
  - fluctuations in manufacturing yields
  - cyclical semiconductor industry conditions
  - our ability to hire and retain key technical and management personnel
  - our access to advanced process technologies
  - the timing and extent of process development costs
- the current California energy crisis

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

### **Customer demand for our products is volatile and difficult to predict**

Our customers continuously adjust their inventories resulting in frequent changes in demand for our products. The volatility of customer demand limits our ability to predict future levels of sales and profitability. The supply of semiconductors can quickly and unexpectedly match or exceed demand because customer end demand can change very quickly. Also, semiconductor suppliers can rapidly increase production output. This can lead to a sudden oversupply situation and a subsequent reduction in order rates and revenues as customers adjust their inventories to true demand rates.

### **Sales of our products are highly dependent on certain select end markets.**

We currently sell a significant portion of our products in the high speed communications, computer and wireless handset markets. These markets are characterized by short product life cycles, rapidly changing customer demand, evolving and competing industry standards and seasonal demand trends. Additionally, there can be no assurance that these markets will continue to grow. If the markets for high speed communications, computers or wireless handsets that we serve fail to grow, or grow more slowly than we currently anticipate, or if we experience increased competition in these markets, our business, results of operations and financial condition will be adversely affected.

### **Our gross margin is dependent upon a number of factors, among them our level of capacity utilization.**

Semiconductor manufacturing is a capital intensive business resulting in high fixed costs. If we are unable to utilize our installed wafer fabrication or test capacity at a high level, the costs associated with these facilities and equipment is not fully absorbed, resulting in higher average unit costs and lower sales margins.

### **Our industry is highly competitive.**

The semiconductor industry is highly competitive and subject to rapid technological change, price-erosion and increased international competition. Significant competitive factors include:

- product features
- performance
- price
- timing of product introductions
- emergence of new computer and communications standards
- quality and customer support

Because the standard products market for integrated circuits is diverse and highly fragmented, we encounter different competitors in our various market areas. Most of these competitors have substantially greater technical, financial and marketing resources and greater name recognition than we do. Due to the increasing demands for integrated circuits, we expect intensified competition from existing integrated circuit suppliers and the entry of new competition. Increased competition could adversely affect our financial condition or results of operations. There can be no assurance that we will be able to compete successfully in either the standard products or custom and foundry products business in the future or that competitive pressures will not adversely affect our financial condition, results of operations, or cash flows.

### **Our product offering is concentrated and a reduction in demand for one of our significant products could reduce our revenues and results of operations.**

We currently derive the majority of our product revenues from sales of standard analog and mixed-signal integrated circuits and we expect these products to continue to account for the majority of our revenues for the foreseeable future. As a result, factors adversely affecting the pricing of or demand for standard analog integrated and mixed-signal circuits, such as competition, product performance or technological change, could have a material adverse effect on our business and consolidated results of operations and financial condition.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**An important part of our strategy is to continue our focus on the market for high-speed communications integrated circuits, or ICs. If we are unable to penetrate this market further, our revenues could stop growing and may decline.**

Our markets frequently undergo transitions in which products rapidly incorporate new features and performance standards on an industry-wide basis. If our products are unable to support the new features or performance levels required by OEMs in these markets, we would likely lose business from existing or potential customers and would not have the opportunity to compete for new design wins until the next product transition. If we fail to develop products with required features or performance standards, or if we experience even a short delay in bringing a new product to market, or if our customers fail to achieve market acceptance of their products, our revenues could be significantly reduced for a substantial period of time.

A significant portion of our revenues in recent periods has been, and is expected to continue to be, derived from sales of products based on SONET, SDH and ATM transmission standards. If the communications market evolves to new standards, we may not be able to successfully design and manufacture new products that address the needs of our customers or gain substantial market acceptance. Although we have developed products for the Gigabit Ethernet and Fibre Channel communications standards, volume sales of these products are modest, and we may not be successful in addressing other market opportunities for products based on these standards.

### **We encounter risks associated with our international operations.**

We have generated a substantial portion of our net revenues from export sales. We believe that a substantial portion of our future net revenues will depend on export sales to customers in international markets, including Asia. International markets are subject to a variety of risks, including changes in policy by foreign governments, social conditions such as civil unrest, and economic conditions including high levels of inflation, fluctuation in the value of foreign currencies and currency exchange rates and trade restrictions or prohibitions. In addition, we sell to domestic customers that do business worldwide and cannot predict how the businesses of these customers may be affected by economic conditions in Asia or elsewhere. Such factors could adversely affect our future revenues, financial condition, results of operations or cash flows.

Our international sales are primarily denominated in U.S. currency. Consequently, changes in exchange rates that strengthen the U.S. dollar could increase the price of our products in the local currencies of the foreign markets we serve. This would result in making our products relatively more expensive than our competitors' products that are denominated in local currencies, leading to a reduction in sales or profitability in those foreign markets. We have not taken any protective measures against exchange rate fluctuations, such as purchasing hedging instruments.

### **We face risks associated with acquisitions we have completed and will face risks associated with any future acquisitions.**

We have made three strategic acquisitions in the past two years: Synergy Semiconductor in November 1998, Altos Semiconductor Inc. in December 1999 and Electronic Technology Corporation in April 2000. On May 4, 2001, the Company announced that it has reached an agreement to acquire Kendin Communications Inc. for approximately 6.2 million shares of Micrel common stock and will be the largest acquisition that the Company has undertaken. The transaction is expected to be completed in the quarter ending June 30, 2001, subject to customary regulatory approvals, and is intended to be accounted for as a pooling of interests. There can be no assurance, however, that the acquisition will be completed in that quarter or at all. The risks involved with acquisitions include:

- diversion of management's attention
- failure to retain key personnel
- amortization of acquired intangible assets
- customer dissatisfaction or performance problems with the acquired company
- the cost associated with acquisitions and the integration of acquired operations
- assumption of unknown liabilities

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

Any of these risks could materially harm our business, financial condition and results of operations. Additionally, there can be no assurance that any of the companies that we acquired or any business that we may acquire in the future will achieve anticipated revenues and operating results.

In addition, acquisitions accounted for using the pooling of interests methods of accounting are subject to rules established by the Financial Accounting Standards Board and the Securities and Exchange Commission. These rules are complex and the interpretation of them is subject to change. Additionally, the availability of pooling of interests accounting treatment for a business combination depends in part upon circumstances and events occurring after the acquisition. The failure of a past business combination or a future potential business combination that has been accounted for under the pooling of interests accounting method to qualify for this accounting treatment would materially harm our reported and future earnings and likely, the price of our common stock.

### **Our operating results substantially depend on manufacturing output and yields, which may not meet expectations.**

We manufacture most of our semiconductors at our San Jose and Santa Clara, California fabrication facilities. Manufacturing semiconductors requires manufacturing tools which are unique to each product being produced. If one of these unique manufacturing tools was damaged or destroyed, then our ability to manufacture the related product would be impaired and our business would suffer until the tool was repaired or replaced. Additionally, the fabrication of integrated circuits is a highly complex and precise process. Small impurities, contaminants in the manufacturing environment, difficulties in the fabrication process, defects in the masks used to print circuits on a wafer, manufacturing equipment failures, wafer breakage or other factors can cause a substantial percentage of wafers to be rejected or numerous die on each wafer to be nonfunctional.

The ongoing expansion of the manufacturing capacity of our existing wafer fabrication facilities could increase the risk of contaminants in the facilities. In addition, many of these problems are difficult to diagnose, and are time consuming and expensive to remedy and can result in lower output and yields and shipment delays.

### **Our future success depends in part on the continued service of our key design engineering, sales, marketing and executive personnel and our ability to identify, hire and retain additional personnel.**

There is intense competition for qualified personnel in the semiconductor industry, in particular design engineers, and we may not be able to continue to attract and train engineers or other qualified personnel necessary for the development of our business or to replace engineers or other qualified personnel who may leave our employ in the future. Loss of the services of, or failure to recruit, key design engineers or other technical and management personnel could be significantly detrimental to our product and process development programs.

### **We may not be able to protect our intellectual property adequately, or we could be harmed by litigation involving our patents and proprietary rights.**

Our future success depends in part upon our intellectual property, including patents, trade secrets, know-how and continuing technology innovation. There can be no assurance that the steps taken by us to protect our intellectual property will be adequate to prevent misappropriation or that others will not develop competitive technologies or products. There can be no assurance that any patent owned by us will not be invalidated, circumvented or challenged, that the rights granted thereunder will provide competitive advantages to us or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. Furthermore, there can be no assurance that others will not develop technologies that are similar or superior to our technology, duplicate our technology or design around the patents owned by us.

Additionally, the semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. There can be no assurance that existing claims or any other assertions or claims for indemnity resulting from infringement claims will not adversely affect our business, financial condition, results of operations, or cash flows.



## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

### **Our business could be adversely effected by electrical power or natural gas supply interruptions.**

The majority of our administrative, technical and manufacturing facilities are located in Northern California and these facilities may be subject to electrical power or natural gas supply interruptions. In recent months, electrical power suppliers have experienced shortages in electrical power which has resulted in brief electrical power interruptions. The weak financial condition of California's Public Utilities may aggravate the situation and shortages may develop for natural gas. Semiconductor manufacturing depends upon a controlled environment which requires high usage of electrical power and natural gas. Frequent or extended electrical power interruptions could have a negative impact on production output, manufacturing yields, and manufacturing efficiencies. The Company intends to implement plans to reduce the impact of temporary power outages. These plans include the installation of emergency electrical power generation equipment. There can be no assurance that these plans will be successful. Frequent or extended electrical power or natural gas interruptions could have a material adverse impact on our business, financial condition and operating results.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's market risk disclosures set forth in the 2000 Form 10-K have not changed significantly during the quarter ended March 31, 2001.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. To the extent that the Company becomes involved in such intellectual property litigation, it could result in substantial costs and diversion of resources to the Company and could have a material adverse effect on the Company's financial condition or results of operations.

On July 2, 1999, National Semiconductor Corporation ("National"), a competitor of the Company, filed a complaint against the Company, entitled National Semiconductor Corporation v. Micrel Semiconductor, Inc. in the United States District Court, Northern District of California, in San Jose, California, alleging that the Company infringes five National Semiconductor patents. The complaint in the lawsuit seeks unspecified compensatory damages for infringement, and treble damages as well as permanent injunctive relief against further infringement of the National patents at issue. The Company intends to continue defending itself against these claims. The litigation is currently in the discovery phase. A trial date has not yet been set by the Court.

On February 26, 1999, the Lemelson Medical, Education & Research Foundation (the "Lemelson Partnership") filed a complaint which was served on the Company on June 15, 1999, entitled Lemelson Medical, Education & Research Foundation, Limited Partnership v. Lucent Technologies Inc., et al. in the United States District Court in Phoenix, Arizona, against eighty-eight defendants, including the Company, alleging infringement of Lemelson Foundation patents. The complaint in the lawsuit seeks unspecified compensatory damages, treble damages and attorneys' fees, as well as injunctive relief against further infringement of the Lemelson patents at issue. The Company intends to defend itself against these claims. The case is currently in the discovery phase and no trial date has been set.

On May 9, 1994, Linear Technology Corporation ("Linear" or "LTC"), a competitor of the Company, filed a complaint against the Company, entitled Linear Technology Corporation v. Micrel, Incorporated, in the United States District Court in San Jose, California, alleging patent and copyright infringement and unfair competition. All claims, except the patent infringement claim, have been settled or dismissed. In this lawsuit, Linear claimed that two of the Company's products infringed one of Linear's patents. The complaint in the lawsuit sought unspecified compensatory damages, treble damages and attorneys' fees as well as preliminary and permanent injunctive relief against infringement of the Linear patent at issue. On August 20, 1999, the United States District Court in San Jose adjudicated in favor of the Company in this patent infringement suit brought by the plaintiff. The plaintiff alleged in the suit that the Company had infringed upon U.S. Patent No. 4,755,741 which covers design techniques used to increase the efficiency of switching regulators. The United States District Court in San Jose found the patent to be invalid under the "on sale bar" defense as the plaintiff had placed integrated circuits containing the alleged invention on sale more than a year before filing its patent application. The United States District Court in San Jose dismissed the plaintiff's complaint on the merits of the case and awarded the Company its legal costs. A notice of appeal of the Judgment was filed by Linear on September 17, 1999. Linear filed its appeal brief with the United States Court of Appeal for the Federal Circuit ("CAFC") in October, 2000. The Company filed its responsive brief with the CAFC in January, 2001.

On June 16, 1999, Paul Boon ("Boon" or "plaintiff"), an ex-employee of the Company, filed a complaint in the Superior Court of California entitled Paul Boon v. Micrel Incorporated, dba Micrel Semiconductor, alleging breach of employment contract, discrimination based upon age, and wrongful termination in violation of public policy. On October 12, 2000, Boon filed an amended complaint alleging breach of an implied covenant of good faith and fair dealing, and breach of written agreement, in addition to the original causes of action. On February 23, 2001, a jury decided that the Company had breached an employment contract with plaintiff and awarded plaintiff \$1.267 million. The Company intends to continue to vigorously defend itself against these claims, up to and including an appeal to the California Court of Appeals and to the Supreme Court for the State of California, if necessary.

The Company believes that the ultimate outcome of the legal actions discussed above will not result in a material adverse effect on the Company's financial condition, results of operation or cash flows. However, litigation is

subject to inherent uncertainties, and no assurance can be given that the Company will prevail in these lawsuits. Accordingly, the pending lawsuits as well as potential future litigation with other companies, could result in substantial costs and diversion of resources and could have a material adverse effect on the Company's financial condition, results of operations or cash flows.

Certain additional claims and lawsuits have arisen against the Company in its normal course of business. The Company believes that these claims and lawsuits will not have a material adverse effect on the Company's financial condition, results of operation or cash flows.

In the event of an adverse ruling in any intellectual property litigation that now exists or might arise in the future, the Company might be required to discontinue the use of certain processes, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to the infringing technology. There can be no assurance, however, that under such circumstances, a license would be available under reasonable terms or at all. In the event of a successful claim against the Company and the Company's failure to develop or license substitute technology on commercially reasonable terms, the Company's financial condition, results of operations, or cash flows could be adversely affected.

#### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

- (a) Exhibits. None.
- (b) Reports on Form 8-K. The Company did not file any Reports on Form 8-K during the quarter ended March 31, 2001.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MICREL, INCORPORATED**  
*(Registrant)*

Date: May 14, 2001

By /s/ Richard D. Crowley, Jr.  
Richard D. Crowley, Jr.  
Vice President, Finance and  
Chief Financial Officer  
*(Authorized Officer and  
Principal Financial Officer)*