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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2004.

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**

M I C R E L, I N C O R P O R A T E D

(Exact name of Registrant as specified in its charter)

California	94-2526744
(State or other jurisdiction of incorporation or organization)	(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 [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act. Yes [X] No [ ]

As of November 1, 2004 there were 90,061,866 shares of common stock, no par value, outstanding.

MICREL, INCORPORATED
INDEX TO
REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2004

ITEM 1. FINANCIAL STATEMENTS

MICREL, INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share amounts)

	September 30, 2004	December 31, 2003 [1]
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 112,321	$ 140,059
Short term investments	36,262	--
Accounts receivable, net	39,158	33,084
Inventories	37,218	31,108
Other current assets	1,642	2,132
Deferred income taxes	30,252	34,294
Total current assets	256,853	240,677
PROPERTY, PLANT AND EQUIPMENT, NET	83,966	87,993
LONG TERM INVESTMENTS	2,009	--
DEFERRED INCOME TAXES	--	2,483
INTANGIBLE ASSETS, NET	7,659	5,771
OTHER ASSETS	454	515
TOTAL	$ 350,941	$ 337,439
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 18,057	$ 12,897
Taxes payable	4,848	7,627
Deferred income on shipments to distributors	16,336	12,272
Other current liabilities	15,229	12,152
Current portion of long-term debt	328	703
Total current liabilities	54,798	45,651
LONG-TERM DEBT	3,350	3,280
DEFERRED INCOME TAXES	3,235	--
OTHER LONG-TERM OBLIGATIONS	2,243	4,899
SHAREHOLDERS' EQUITY:		
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: 2004 – 90,500,420 shares; 2003 - 92,522,513 shares	135,216	160,015
Deferred stock compensation	(1,598)	(3,954)
Accumulated other comprehensive loss	(35)	(25)
Retained earnings	153,732	127,573
Total shareholders' equity	287,315	283,609
TOTAL	$ 350,941	$ 337,439

(1) Derived from the audited balance sheet included in the Annual Report on Form 10-K of Micrel, Incorporated for the year ended December 31, 2003.

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

MICREL, INCORPORATED

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
NET REVENUES	$ 67,853	$ 53,364	$ 198,110	$ 153,428
COST OF REVENUES[1] (NOTE 11)	34,598	32,160	102,933	93,451
GROSS PROFIT	33,255	21,204	95,177	59,977
OPERATING EXPENSES:				
Research and development (NOTE 11)	11,145	11,500	31,390	36,325
Selling, general and administrative (NOTE 11)	9,955	7,263	27,394	20,837
Amortization of deferred stock compensation[1]	487	834	1,659	2,515
Purchased in-process technology	--	--	480	--
Manufacturing facility impairment	--	(624)	--	(624)
Restructuring expense	437	286	437	286
Total operating expenses	22,024	19,259	61,360	59,339
INCOME FROM OPERATIONS	11,231	1,945	33,817	638
OTHER INCOME, NET	363	150	901	497
INCOME BEFORE INCOME TAXES	11,594	2,095	34,718	1,135
PROVISION FOR INCOME TAXES (NOTE 11)	4,058	482	8,559	261
NET INCOME	$ 7,536	$ 1,613	$ 26,159	$ 874
NET INCOME PER SHARE:				
Basic	$ 0.08	$ 0.02	$ 0.28	$ 0.01
Diluted	$ 0.08	$ 0.02	$ 0.28	$ 0.01
WEIGHTED-AVERAGE SHARES USED IN COMPUTING PER SHARE AMOUNTS:				
Basic	91,252	92,032	91,968	92,174
Diluted	91,996	93,735	93,735	93,317
(1) Amortization of deferred stock compensation:				
Included in cost of revenues	$ 109	$ 279	$ 479	$ 870
Amortization of deferred stock compensation included in operating expenses related to:				
Research and development	$ 173	$ 462	$ 609	$ 1,471
Selling, general and administrative	314	372	1,050	1,044
Total operating expenses	$ 487	$ 834	$ 1,659	$ 2,515

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

MICREL, INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	**Nine Months Ended September 30, 2004**	**Nine Months Ended September 30, 2003**
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 26,159	$ 874
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,816	22,046
Stock based compensation	2,138	3,385
Manufacturing facility impairment	--	(624)
Purchased in-process technology	480	--
(Gain) loss on disposal of assets	114	(3)
Deferred rent	--	19
Deferred income taxes	10,200	4,998
Changes in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable	(5,400)	(2,629)
Inventories	(5,930)	2,507
Prepaid expenses and other assets	693	(53)
Accounts payable	4,749	(1,659)
Income taxes	(2,294)	(4,319)
Other accrued liabilities	(972)	32
Deferred income on shipments to distributors	4,064	1,298
Net cash provided by operating activities	52,817	25,872
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(13,558)	(15,758)
Purchase of intangible assets	(1,030)	--
Purchases of short-term investments	(35,096)	--
Purchases of long-term investments	(3,185)	--
Purchase of BlueChip Communications, net of cash acquired	(2,033)	--
Net cash used in investing activities	(54,902)	(15,758)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(587)	(735)
Proceeds from the issuance of common stock, net	3,958	3,531
Repurchase of common stock	(29,024)	(3,501)
Net cash used in financing activities	(25,653)	(705)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(27,738)	9,409
CASH AND CASH EQUIVALENTS - Beginning of period	140,059	117,363
CASH AND CASH EQUIVALENTS - End of period	$ 112,321	$ 126,772
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 262	$ 513
Income taxes	$ 964	$ 661
Non-cash transactions:		
Deferred stock compensation (reversal)	$ (218)	$ (1,562)

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

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 September 30, 2004 and for the three and nine months ended September 30, 2004 and 2003 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, 2003. This financial data should also be read in conjunction with the Company's critical accounting policies included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Weighted-average common shares outstanding	91,252	92,032	91,968	92,174
Dilutive effect of stock options outstanding using the treasury stock method	744	1,703	1,767	1,143
Shares used in computing diluted net income per share	91,996	93,735	93,735	93,317

For the three and nine months ended September 30, 2004, 7.7 million and 4.7 million stock options, respectively, have been excluded from the weighted-average number of common shares outstanding for the diluted net income per share computations as they were anti-dilutive. For the three and nine months ended September 30, 2003, 3.9 million and 5.0 million stock options, respectively, have been excluded from the weighted-average number of common shares outstanding for the diluted net loss per share computations as they were anti-dilutive.

Stock Based Awards **-** The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees".

Beginning in 1996, the Company began to follow a practice of granting employee stock options on the date with the lowest closing price within the thirty-day period subsequent to the employee's date of hire (the "Thirty-Day Method"). The Company continued to utilize this method generally but not uniformly, both for new hires and for replenishment grants to existing employees, until December 20, 2001. At that time, the Company determined that options granted using the Thirty-Day Method were compensatory under APB No 25, and discontinued use of the Thirty-Day Method thereafter. As a result, the Company restated its financial statements for the years ended December 31, 1998, 1999, and 2000, and the quarters ended March 31, 2001, June 30, 2001, and September 30, 2001 to reflect previously unrecorded stock compensation expense and related payroll tax and income tax effects of the Thirty-Day Method. For financial reporting purposes, per APB No 25, the measurement date for determining compensation cost in stock option plans is the first date on which are known both (1) the number of shares that an individual is entitled to receive and (2) the option purchase price. Compensation cost is calculated for any difference between the option exercise price and the fair market value on the measurement date. When applying APB 25 to the Thirty-Day Method described above, the measurement date was the thirtieth day following a new-hire's commencement of employment, when the lowest price (the exercise price) within the first thirty days following employment commencement was known. Compensation expense related to options granted under the Thirty-Day Method was calculated and recorded based on the price difference between the closing price on the date of grant and the closing price on the thirtieth day following a new-hire's commencement of employment multiplied by the number of options granted and recognized as expense over the vesting period (generally five years). The Company is continuing to recognize stock compensation expense for amortization of options granted under the Thirty-Day method.

In addition to the stock options granted using the Thirty-Day Method, Micrel assumed certain stock options granted to employees of Kendin Communications in connection with the acquisition of Kendin Communications in the second quarter of 2001. Because the fair market value of the shares subject to those options assumed in the Kendin acquisition exceeded their exercise prices as of the date Micrel assumed them, the Company recorded deferred stock compensation expense for the unvested portion of the assumed options.

Deferred stock compensation expense balances are recorded as a contra-equity amount and amortized as a charge to operating results over the applicable vesting periods. As of September 30, 2004 total unamortized stock compensation related to the Thirty-Day Method and the Kendin Communication acquisition noted above was $1.6 million and approximately $2.1 million and $3.4 million of compensation expense was recorded during the nine months ended September 30, 2004 and 2003, respectively.

SFAS No. 123, "Accounting for Stock-Based Compensation," requires the disclosure of pro forma net income (loss) and net income (loss) per share had the Company applied the fair value method. Under SFAS 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company’s stock option awards. These models also require subjective assumptions, including future stock volatility and expected time to exercise, which greatly affect the calculated values.

The Company’s calculations for the fair value of stock options were made using the Black-Scholes option pricing model. Calculations are based on a multiple option valuation approach with forfeitures recognized as they occur and the following weighted average assumptions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2004	**2003**	**2004**	**2003**
Expected life (months)	60	60	60	60
Stock volatility	85.2%	85.0%	83.9%	85.5%
Risk free interest rates	3.4%	3.2%	3.3%	2.8%
Dividends during expected terms	none	none	none	none

The Company’s calculations for the fair value of stock issued under the employee stock purchase plan were made using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2004	**2003**	**2004**	**2003**
Expected life (months)	6	6	6	6
Stock volatility	85.2%	85.0%	83.9%	85.5%
Risk free interest rates	2.0%	1.0%	1.5%	1.0%
Dividends during expected terms	none	none	none	none

SFAS No. 148 was issued in December 2002 and amended SFAS No. 123 to require that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format.

The following table illustrates the effect on the Company's net income (loss) and net income (loss) per share if it had recorded compensation costs based on the estimated grant date fair value as defined by SFAS No. 123 for all granted stock-based awards. (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net income as reported	$ 7,536	$ 1,613	$ 26,159	$ 874
Add: stock-based employee compensation expense included in reported net income, net of tax effects	362	677	1,300	2,058
Deduct: stock-based employee compensation expense determined under fair value based method, net of tax effects	(2,972)	(3,395)	(9,007)	(10,244)
Pro forma net income (loss)	$ 4,926	$ (1,105)	$ 18,452	$ (7,312)
Net income (loss) per share as reported:				
Basic	$ 0.08	$ 0.02	$ 0.28	$ 0.01
Diluted	$ 0.08	$ 0.02	$ 0.28	$ 0.01
Pro forma net income (loss) per share:				
Basic	$ 0.05	$ (0.01)	$ 0.20	$ (0.08)
Diluted	$ 0.06	$ (0.01)	$ 0.20	$ (0.08)

2. RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the Financial Accounting Standards Board ("FASB" or the "Board") issued Interpretation No. 46 ("FIN 46") "Consolidation of Variable Interest Entities." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. In December 2003, the FASB issued a revision of FIN 46 that delays the implementation date for certain interests created or acquired prior to January 31, 2003 until the first interim or annual period ending after March 15, 2004. The adoption of this statement had no material effect on the Company's consolidated financial statements.

In May 2003, the FASB issued Statement of Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial position. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. While the effective date of certain elements of SFAS No. 150 have been deferred, the adoption of such elements when finalized is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on recognition and measurement guidance previously discussed under EITF Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." ("EITF 03-01"). The consensus clarifies the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method. This consensus is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. The adoption of this statement had no material effect on the Company's consolidated financial statements.

In April 2004, the Emerging Issues Task Force issued Statement No. 03-06 "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share" ("EITF 03-06"). EITF 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 became effective during the quarter ended June 30, 2004, the adoption of which did not have any impact on the Company's calculation of net income per share.

3. INVESTMENTS

Short-term and long-term investments consist primarily of liquid debt instruments and are classified as available-for-sale securities and are stated at market value with unrealized gains and losses included in shareholders' equity. Investments purchased with remaining maturity dates of greater than three months and less than 12 months are classified as short-term. Investments purchased with remaining maturity dates of 12 months or greater are classified as long-term as the Company expects, but is not committed to hold them to maturity. A summary of investments at September 30, 2004 is as follows (in thousands):

	Amortized Cost	Market Value	Unrealized Holding Gains	Unrealized Holding Losses
Short-term investments	$ 36,295	$ 36,262	$ —	$ 33
Long-term investments	$ 2,011	$ 2,009	$ —	$ 2

4. INVENTORIES

Inventories consist of the following (in thousands):

	September 30, 2004	December 31, 2003
Finished goods	$ 16,055	$ 9,787
Work in process	20,102	20,425
Raw materials	1,061	896
	$ 37,218	$ 31,108

5. BORROWING ARRANGEMENTS

Borrowing arrangements consist of a $5 million revolving line of credit from a commercial bank. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. There were no borrowings under the revolving line of credit at September 30, 2004, and there were $550,000 in standby letters of credit outstanding. The revolving line of credit agreement expires on June 30, 2005. Borrowings under the revolving line of credit bear interest rates of, at the Company's election, the prime rate (4.75% at September 30, 2004), or the bank's revolving offshore rate, which approximates LIBOR (2.0% at September 30, 2004) plus 2.0%. 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 September 30, 2004.

In September 2002, the Company borrowed $10.7 million through a commercial mortgage financing agreement which was associated with the purchase of its previously leased manufacturing facilities in San Jose, CA. Borrowings under this agreement bear interest, at the Company's election, at the daily floating prime rate (4.75% at September 30, 2004), or adjustable monthly LIBOR (2.0% at September 30, 2004) plus 1.5%. The principal balance of the loan is to be repaid in 59 consecutive monthly installments of $16,890 and one final installment in the amount necessary to pay in full the remaining outstanding principal balance, with no early payment penalty. In December 2003, the company repaid $7.0 million of the loan, resulting in a remaining loan balance of $3.3 million at September 30, 2004. The mortgage agreement contains certain restrictive covenants with which the Company was in compliance at September 30, 2004.

As of September 30, 2004, the Company had $3.7 million under term notes outstanding, including the commercial mortgage loan.

6. SIGNIFICANT CUSTOMERS

During the nine months ended September 30, 2004, two customers, a world wide distributor and an Asian based stocking representative accounted for $27.5 million (14%) and $26.7 million (13%) of net revenues, respectively, and no direct original equipment manufacturer ("OEM") accounted for 10% or more of net revenues. During the nine months ended September 30, 2003, the same two customers accounted for $19.4 million (13%) and $17.9 million (12%) of net revenues, respectively, and no direct OEM accounted for more than 10% of net revenues.

As of September 30, 2004, two customers, an Asian based stocking representative and an OEM, accounted for 17% and 13%, respectively, of net accounts receivable. At December 31, 2003, two customers accounted for 19% and 13% of net accounts receivable.

7. 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 $7.5 million and $26.2 million for the three and nine months ended September 30, 2004, respectively, and $1.6 million and $874,000 for the three and nine months ended September 30, 2003, respectively.

8. SEGMENT REPORTING

The Company follows the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information and operates in two reportable segments: standard products and custom and foundry products. The chief operating decision maker evaluates segment performance based primarily on revenue. Accordingly, all expenses are not allocated to segments. Therefore, it is not practical to show profit or loss by operating segments. Also, the chief operating decision maker does not assign assets to these segments. Consequently, it is not practical to show assets by operating segments.

Net Revenues by Segment
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net Revenues:				
Standard Products	$ 65,332	$ 48,182	$ 190,084	$ 137,016
Custom and Foundry Products	2,521	5,182	8,026	16,412
Total net revenues	$ 67,853	$ 53,364	$ 198,110	$ 153,428
As a Percentage of Total Net Revenues:				
Standard Products	96%	90%	96%	89%
Custom and Foundry Products	4%	10%	4%	11%
Total net revenues	100%	100%	100%	100%

9. LITIGATION AND OTHER CONTINGENCIES

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 case is currently in the motion and hearing phase. The Company intends to continue to defend itself against these claims.

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. The complaint in the lawsuit seeks 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 on a motion, finding the patent to be invalid under the “on sale bar” defense as the plaintiff had placed ICs 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. Linear appealed the trial Court's decision to the United States Court of Appeal for the Federal Circuit ("CAFC") on September 17, 1999. On December 28, 2001, the CAFC reversed the District Court’s judgment of invalidity and remanded the case to the District Court. After the Company's Petition for Rehearing En Banc by the Court of Appeal was denied, the Company filed a Petition for Writ of Certiorari with the Supreme Court of the United States, which Linear opposed. On May 19, 2003, the Supreme Court denied the Petition for Writ of Certiorari. The District Court subsequently determined a schedule for further discovery and hearing matters before the Court. A claim construction hearing (also called a “Markman” hearing) was held before the District Court on December 16, 2003. The Court issued its ruling on January 24, 2004, interpreting the claims at issue in the litigation. Furthermore, the parties have attended three settlement conferences before the District Court. A status conference was held with the Court on November 8, 2004. At the status conference, a trial date was set for June 28, 2005. The Company intends to continue to defend itself against the claims alleged in this litigation.

On December 27, 2002, the Company filed a complaint against TRW, Inc. (“TRW”) entitled Micrel, Incorporated v. TRW, Inc., dba TRW Automotive Electronics Group, in the United States District Court, Northern District of Ohio, Eastern Division, alleging various causes of action relating to breach of a relationship surrounding the development of certain custom products by Micrel for TRW. In this lawsuit, Micrel is alleging that TRW breached various agreements to assist in Micrel's development of, and to purchase, certain Application Specific Integrated Circuits. The complaint seeks compensatory damages, attorneys' fees and costs of suit. On February 24, 2003, TRW filed an answer to the Company's complaint and a counterclaim alleging various causes of action relating to breach of the above-mentioned relationship concerning ASIC development. The Company intends to vigorously defend itself against these counterclaims. The case is currently in the motion and discovery phase. A case management and settlement conference is scheduled with the Court for December 7, 2004.

On April 21, 2003, the Company filed a complaint against its former principal accountants Deloitte & Touche LLP ("Deloitte") entitled Micrel, Incorporated v. Deloitte & Touche LLP in the Superior Court of the State of California, County of Santa Clara, alleging various causes of action relating to certain professional advice received by Micrel from Deloitte. In this lawsuit, Micrel is alleging that Deloitte negligently rendered services as accountants to Micrel, breached certain agreements with Micrel by failing to perform services using ordinary skill and competence and in conformance with generally accepted principles for such work and made certain false representations upon which Micrel justifiably relied. As a direct result of Deloitte's actions, Micrel alleges damages including: expenses incurred in the form of payments to various professionals to address the impact on Micrel's financial statements and other effects of the wrongful conduct; loss of cash as well as equity from stock options; additional charges to earnings that Micrel would not incur but for the wrongful advice; additional potential liability for taxes; potential liability for tax penalties; and the harm to Micrel in both financial and semiconductor markets resulting in loss of overall value of the company as a whole. Deloitte has denied all allegations in the complaint. The complaint seeks compensatory damages, costs of suit and such other relief that the court may deem just and proper. The case is currently in the discovery phase. A trial setting conference is scheduled with the Court for January 4, 2005.

Based on the status to date of the above litigation, 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 and, the Company believes it is not reasonably possible that a material loss has been incurred. 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.

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, in addition to litigation mentioned herein, 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, 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. Based on the status of the litigation described above, the Company does not believe that any material and specific risk exists related to the loss of use of patents, products or processes.

Certain additional claims have been filed by or 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.

10. STOCK REPURCHASE PROGRAM

On August 30, 2004, Micrel's Board of Directors amended the Company's common stock repurchase program and authorized the repurchase of common stock up to a maximum value of $75 million during the period from January 1, 2004 through June 30, 2005. Shares of common stock purchased pursuant to the repurchase program are cancelled upon repurchase, and are intended to offset dilution from the Company's stock option plans, employee stock purchase plans and 401(k) plan. During the nine months ended September 30, 2004, the Company repurchased 2,561,900 shares of its common stock for $29.0 million.

11. INCOME TAXES

Deferred tax assets and liabilities result primarily from temporary differences between book and tax bases of assets and liabilities, state and federal research and development credit carryforwards and state manufacturers credit carryforwards. The Company had net current deferred tax assets of $30.3 million and net long-term deferred tax liabilities of $3.2 million as of September 30, 2004. The Company must assess the likelihood that future taxable income levels will be sufficient to ultimately realize the tax benefits of these deferred tax assets. The Company currently believes that future taxable income levels will be sufficient to realize the tax benefits of these deferred tax assets and has not established a valuation allowance. Should the Company determine that future realization of these tax benefits is not likely, a valuation allowance would be established, which would increase the Company's tax provision in the period of such determination.

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company records liabilities for anticipated tax audit issues based on its estimate of whether, and the extent to which, additional taxes may be due. Actual tax liabilities may be different than the recorded estimates and could result in an additional charge or benefit to the tax provision in the period when the ultimate tax assessment is determined.

During the second quarter of 2004, the Company reversed $3.8 million of accrued income tax liabilities as a result of the completion of a federal income tax audit. In May 2004, the Company received an audit report from the Internal Revenue Service ("IRS") which recommended no changes to Micrel's federal tax return filings covering the tax years 1994 through 2001. In addition, the Company subsequently received a notice dated July 6, 2004 from the Joint Committee on Taxation which stated that the committee took no exceptions to conclusions in the IRS audit report. This reversal of accrued income tax liabilities was recorded as a reduction to provision for income taxes in the second quarter of 2004.

In addition, related to the federal tax audit completion, the Company also reversed $3.9 million (offset in part by a $1.4 million income tax effect) in accrued payroll tax liabilities, which were previously recorded as part of the Company's restatement of financials for the years December 31, 1998, 1999, and 2000, and the quarters ended March 31, 2001, June 30, 2001, and September 30, 2001 to reflect previously unrecorded stock compensation expense and related payroll tax and income tax effects.

The effects of these accrued tax liability reversals on the below-noted items in the Company's statement of operations is summarized as follows (there was no effect of these accrued tax liability reversals during the three months ended September 30, 2004):

	Nine Months Ended September 30, 2004
Cost of revenues	$ (1,111)
Research and development	(1,697)
Selling, general and administrative	(1,140)
Provision (benefit) for income taxes	(2,378)
Net income (loss)	$ (6,326)

The income tax provision for the three and nine months ended September 30, 2004 is based on the Company's estimated annual effective tax rate of 35% of pretax income, reduced by the $3.8 million reversal of accrued income tax liabilities recorded in the second quarter of 2004 and increased by $168,000 as a result of $480,000 of non-deductible purchased in-process technology charges recorded in the first quarter of 2004.

12. CLOSURE OF WAFER FABRICATION FACILITY

In September 2002, the Company approved a plan to close its Santa Clara, California wafer fabrication facility to reduce costs and improve operating efficiencies. The Company accrued $5.5 million in restructuring expenses associated with the facility closure which consisted of $1.0 million for equipment disposal costs and $4.5 million in net contractual building lease costs, excluding estimated sublease income, that will provide no future benefit. During July 2003, the Company ceased all manufacturing processes within the Santa Clara facility and completed the relocation of all employees to its San Jose, CA facilities. During the third quarter of 2004, the Company increased its accrued restructuring expenses for contractual building lease costs by $437,000 due to a reduction in estimated future sub-lease income. Estimated future sub-lease income at September 30, 2004 was $148,000.

During the third quarter of 2003, the Company also incurred and paid severance costs of $320,000 related to the termination of 46 employees associated with the wafer fabrication facility closure. The affected employees consisted primarily of wafer fabrication operators and maintenance technicians. These termination costs have been reported as restructuring expense in the statement of operations.

A summary of restructuring expense accrual is as follows: ($000)

		Severance Costs	Contractual Facility Costs	Equipment Disposal	Total
Balance December 31, 2002		$ --	$ 4,536	$ 1,000	$ 5,536
2003	Charges	320	466	(500)	286
	Uses	(320)	(883)	(89)	(1,292)
Balance December 31, 2003		$ --	$ 4,119	$ 411	$ 4,530
2004	Charges	--	437	--	437
	Uses	--	(1,241)	(51)	(1,292)
Balance September 30, 2004		$ --	$ 3,315	$ 360	$ 3,675

Of the $3.7 million in accrued restructuring costs, $2.0 million has been classified as other current liabilities and the remaining $1.7 million has been classified as other long-term obligations as of September 30, 2004. These restructuring costs are expected to be paid in cash over the remaining facility lease term, which expires in October 2006. Actual future costs or actual sublease income may be different than these estimates and could require an adjustment to the restructuring accrual in the period such determination is made.

Also related to the facility closure, in September 2002, the Company recorded a $23.4 million impairment of long-lived assets to reduce the net book value of the facility's leasehold improvements and equipment to fair value. The fair value was determined by management based on the estimated net realizable sales value. A number of factors were considered to estimate the net realizable sales value including a third party appraisal of the equipment to be sold, which was primarily based on comparable sales from recent equipment auctions, liquidations and other used equipment sales. In the third quarter of 2003, the company sold previously impaired equipment which resulted in a $624,000 gain, recognized as an adjustment to manufacturing facility impairment expense in the third quarter of 2003. As of September 30, 2003, there was no remaining book value for equipment previously impaired during the 2002 restructuring actions.

13. ACQUISITION

On March 3, 2004, Micrel acquired a controlling interest in BlueChip Communications AS ("BlueChip") of Oslo, Norway. BlueChip is a fabless semiconductor company that designs, develops and markets high performance Radio Frequency integrated circuits and modules for the actuation and connectivity markets. Micrel ultimately acquired 100% of the outstanding BlueChip common stock and options to purchase BlueChip common stock in a cash-for-stock transaction. Under the terms of the agreement, Micrel paid approximately $2 million and incurred approximately $300,000 in direct acquisition costs for the outstanding BlueChip securities and options. Also, Micrel may pay additional consideration of approximately $1 million if certain revenue and gross profit targets are met by the BlueChip operation during calendar year 2004, however, such payment would not be made until 2005. The acquisition was accounted for as a purchase under SFAS 141 "Business Combinations" and, accordingly, the results of operations of BlueChip from the date of acquisition forward have been included in the Company's condensed consolidated financial statements.

An amount of $480,000 was allocated to purchased in-process technology, which has not reached technological feasibility and has no alternative future use, for which the Company recorded a charge to the line item purchased in-process technology in the condensed consolidated statement of operations for the three months ended March 31, 2004. In addition, $1.7 million was allocated to existing technology and $450,000 was allocated to customer relationships and are included in intangible assets in the accompanying condensed consolidated balance sheet. These intangible assets are expected to be amortized over their useful lives of five and three years, respectively. The amounts assigned to existing technology, customer relationships and purchased in-process technology were determined by management, based in part on a valuation by an independent appraisal firm based on management's forecast of future revenues, cost of revenues and operating expenses related to the purchased technologies. The calculation gave consideration to relevant market sizes and growth factors, expected industry trends, the anticipated nature and timing of new product introductions, individual product cycles, and the estimated lives of each of the products underlying the technology. In-process research and development costs consist of five research and development projects that had not yet reached technological feasibility at the time of acquisition.

The Company has not presented supplemental pro-forma results of operations reflecting the impact of the BlueChip acquisition as the effect is not material.

In addition, Micrel has recorded an intangible asset of $800,000 for the license of certain developed technology pursuant to a pre-acquisition development and license agreement which was entered into with BlueChip in 2001. This intangible asset is being amortized over its estimated useful life of five years.

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

Overview

The 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 or strategies regarding the future. Forward-looking statements include: statements regarding future products or product development; statements regarding future research and development spending and the Company's product development strategy; statements regarding the levels of international sales; statements regarding future expansion or utilization of manufacturing capacity; statements regarding future expenditures; and statements regarding 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 are set forth below. Additional factors that may affect operating results are contained within the Company's Form 10-K for the year ended December 31, 2003.

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

Rapid growth in worldwide dollar shipments of semiconductors of 38% in 2000 was followed by the most severe downturn in the history of the semiconductor industry in 2001. Customer demand for the Company's products declined sharply in 2001 as customers reacted to the economic recession in the United States and high inventory levels of semiconductor components by reducing order rates. The resulting environment, which continued from the beginning of 2001 through the second quarter of 2003, was characterized by reduced demand for the Company's products, especially from customers serving the high speed communications market, and by poor visibility into future customer demand. The Company's gross profit and net income declined in 2001 and 2002 due to lower unit volume, declining selling prices for the Company's products and an increased level of unabsorbed fixed costs due to lower utilization levels of the Company's wafer fabrication lines. In response to this environment, the Company focused on reducing costs in 2001, 2002 and 2003.

The Company's objective was to align its cost structure with the reduced revenue levels while retaining sufficient manufacturing capacity, and sustaining a level of research and development investment that should facilitate future growth. In addition to reducing discretionary spending and payroll costs, the Company sought to significantly reduce its manufacturing costs. One of the Company's most significant cost reduction actions was the consolidation of its Santa Clara, California wafer fabrication operation into its San Jose, California wafer fabrication facility. This action commenced in 2002 and was completed in 2003 (see Note 12 of Notes to Condensed Consolidated Financial Statements). By the end of 2003, the Company's manufacturing cost reduction efforts had offset a substantial portion of the erosion in gross profit resulting from the decline in average selling prices. The Company continued to invest in research and development at a rate in excess of 20% of revenues while selling, general and administrative spending was reduced to a level in 2003 which approached 1999 spending. Throughout the 2001 to 2003 period the Company continued to generate positive cash flows from operations.

In 2003 the Company returned to profitability after recording a loss on an annual basis for the first time in its history in 2002. The first half of 2003 was characterized by the continuation of limited visibility into, and uncertainty of, customer demand. The uncertainty of demand was compounded in the first half of 2003 by events such as the war in Iraq and the outbreak of severe acute respiratory syndrome in Asia ("SARS"). The Company's quarterly revenues remained relatively flat, averaging $50 million per quarter for the first half of 2003. The Company recorded a small net loss for this period. In the second half of 2003, customer demand increased as the United States' and Asian economies began to grow more rapidly. The Company's new order rates, or bookings, grew faster than revenue in the third and fourth quarter of 2003, resulting in sequential growth in both revenues and order backlog. The growth in new orders and revenues in the second half of 2003 was driven by demand for the Company's standard products from customers serving the communications, computing, industrial and wireless handset end markets. Gross margins and net income increased in the second half of 2003.

In the first quarter of 2004, demand for the Company's products increased. New order rates increased compared with both the first and fourth quarters of 2003. Customers increased order lead times in response to general concern about the availability of semiconductor component supply. Strength in demand from customers serving the industrial and wireline communications end markets offset seasonal slowness in demand from customers in the computing and wireless handset markets, resulting in higher revenues on both a sequential and year-over-year basis. The combination of higher revenues, a richer, higher margin sales mix and lower manufacturing costs led to an improved gross profit margin of 45% in the first quarter.

In the second quarter of 2004, revenues, gross margin, operating margin and net income continued to increase. Demand for the Company's products remained solid with new order levels approximately equal to the level of revenue for the quarter. Order lead times exiting the second quarter remained at approximately seven to eight weeks, about the same as the end of the first quarter. Gross profit margin increased on both a sequential and year-over-year basis. The improvement in gross margin was due primarily due to higher sales volume combined with higher factory utilization which spread fixed costs over higher unit volume, and a more favorable product mix compared with the second quarter of 2003. Second quarter and year-to-date operating expenses were approximately $800 thousand less than the year ago period due to the reversal of $2.8 million of accrued payroll tax liabilities associated with the conclusion of a tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements). Operating profit and net income increased for the fourth consecutive quarter.

In the third quarter of 2004, demand was below normal seasonal levels as customers reacted quickly to uncertain demand for their products, decreasing semiconductor lead times and uncertain economic conditions by reducing their order rates. Because of the lessons learned from the painful excess inventory situation that occurred in 2001, the Company's customers appear to be more sensitive to changes in end demand for their products and supplier lead times. In the first half of 2004, most OEM customers, distributors and stocking representatives increased the amount of inventory they held of the Company's products in response to expanding lead times from many suppliers and anticipated increases in end demand. In the third quarter, the Company's customers serving the high speed communications, industrial, enterprise computing and networking end markets appear to have experienced lower demand for their end products than they anticipated. This factor, combined with rapidly shrinking lead times from most semiconductor suppliers, led to lower order rates for the Company's products as customers attempted to control their inventory levels. Inventories at the Company's distributors declined on a sequential basis as a result of sharply reduced order rates throughout the third quarter. Inventories at the Company's stocking representatives continued to grow in the third quarter due to lower than forecasted demand from the enterprise computing, high speed communications and enterprise networking end markets, and increased stocking in anticipation of stronger seasonal demand trends which are typical in the second half of the calendar year. The Company anticipates that the overall inventories at stocking representatives will decline sequentially in the fourth quarter, which may reduce the Company's revenues, as these customers purchase less of the Company's products in an attempt to reduce the amount of inventory they hold. The Company's level of on hand finished goods inventory has also increased in the first nine months of 2004 as the Company has built safety stock in an attempt to provide a high level of customer service. The level of finished goods inventory on hand also increased on a sequential basis as result of weaker than anticipated demand and maintenance of higher stocking levels to respond to shorter customer lead times.

As a result of lower order rates, third quarter 2004 revenues declined by 2% on a sequential basis. However, revenues, gross margin, operating margin and net income remained well above the year ago period. Gross profit, operating profit and net income were below second quarter 2004 levels primarily due to reversal of accrued payroll and income tax liabilities that occurred in the second quarter as a result of the completion of a federal income tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements).

On March 3, 2004, Micrel acquired a controlling interest in BlueChip Communications AS ("BlueChip") of Oslo, Norway. BlueChip is a fabless semiconductor company that designs, develops and markets high performance Radio Frequency integrated circuits and modules for the actuation and connectivity markets. The acquisition was accounted for as a purchase under SFAS 141 "Business Combinations" and, accordingly, the results of operations of BlueChip from the date of acquisition forward have been included in the Company's condensed consolidated financial statements. In addition, $480,000 was expensed to purchased in-process technology in the first quarter of 2004 (see Note 13 of Notes to Condensed Consolidated Financial Statements).

The Company derives a substantial portion of its net revenues from standard products. For each of the three and nine month periods ended September 30, 2004 the Company's standard products sales accounted for 96%, of the Company's net revenues as compared to 90% and 89%, respectively for the comparable periods in 2003. 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.

Critical Accounting Policies and Estimates

The financial statements included in this Form 10-Q and discussed within this Management's Discussion and Analysis of Financial Condition and Results of Operations have been prepared in accordance with accounting principles generally accepted in the United States. Preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a detailed discussion of the Company's significant accounting policies, see Note 1 of Notes to Consolidated Financial Statements in Item 14 of the Company's Annual Report on Form 10 K for the year ended December 31, 2003.

Revenue Recognition and Receivables. Micrel generates revenue by selling products to original equipment manufacturers ("OEM"s), distributors and stocking representatives. Stocking representative firms may buy and stock the Company's products for resale or may act as the Company's sales representative in arranging for direct sales from the Company to an OEM customer. The Company's policy is to recognize revenue from sales to customers when the rights and risks of ownership have passed to the customer, when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable and collection of the resulting receivable is reasonably assured.

Micrel allows certain distributors, primarily located in North America and Europe, and to a lesser extent Asia, significant return rights, price protection and pricing adjustments subsequent to the initial product shipment. As these returns and price concessions have historically been significant, and future returns and price concessions are difficult to reliably estimate, the Company defers recognition of revenue and related cost of sales (in the balance sheet line item "deferred income on shipments to distributors") derived from sales to these distributors until they have resold the Company's products to their customers. Although revenue recognition and related cost of sales are deferred, the Company records an accounts receivable and relieves inventory at the time of initial product shipment. As standard terms are FOB shipping point, payment terms are enforced from shipment date and legal title and risk of inventory loss passes to the distributor upon shipment.

Sales to OEM customers and Asian based stocking representatives are recognized upon shipment. The Company does not grant return rights, price protection or pricing adjustments to OEM customers. The Company offers limited contractual stock rotation rights to stocking representatives. In addition, the Company is not contractually obligated to offer, but may infrequently grant, price adjustments or price protection to certain stocking representatives on an exception basis. At the time of shipment to OEMs and stocking representatives, an allowance for returns and price adjustments is established based upon historical return rates. Actual future returns or price adjustments could be different than the returns allowance established.

The Company also maintains an allowance for doubtful accounts for estimated uncollectible accounts receivables. This estimate is based on an analysis of specific customer creditworthiness and historical bad debts experience. Actual future uncollectible amounts could exceed the doubtful accounts allowance established.

Inventory Valuation. Inventories are stated at the lower of cost (first-in, first-out method) or market. The Company records adjustments to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecasted demand for its products. If actual future demand for the Company's products is less than currently forecasted, additional inventory adjustments may be required. Once a reserve is established, it is maintained until the product to which it relates is sold or otherwise disposed of. This treatment is in accordance with Accounting Research Bulletin 43 and SEC Staff Accounting Bulletin 100 "Restructuring and Impairment Charges."

Income Taxes. Deferred tax assets and liabilities result primarily from temporary differences between book and tax bases of assets and liabilities, state and federal research and development credit carryforwards and state manufacturers credit carryforwards. The Company had net current deferred tax assets of $30.3 million and net long-term deferred tax liabilities of $3.2 million as of September 30, 2004. The Company must assess the likelihood that future taxable income levels will be sufficient to ultimately realize the tax benefits of these deferred tax assets. The Company currently believes that future taxable income levels will be sufficient to realize the tax benefits of these deferred tax assets and has not established a valuation allowance. Should the Company determine that future realization of these tax benefits is not likely, a valuation allowance would be established, which would increase the Company's tax provision in the period of such determination.

In addition, the calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company records liabilities for anticipated tax audit issues based on its estimate of whether, and the extent to which, additional taxes may be due. Actual tax liabilities may be different than the recorded estimates and could result in an additional charge or benefit to the tax provision in the period when the ultimate tax assessment is determined.

During the second quarter of 2004, the Company reversed $3.8 million of accrued income tax liabilities as a result of the completion of a federal income tax audit. In addition, related to the federal tax audit completion, the Company also reversed $3.9 million in accrued payroll tax liabilities. This reduction in accrued payroll tax liabilities has been recorded as a $1.1 million reduction in cost of revenues, a $1.7 million reduction in research and development expense and a $1.1 million reduction in selling, general and administrative expense in the second quarter of 2004 (see Note 11 of Notes to Condensed Consolidated Financial Statements).

Litigation. The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. The Company is currently involved in such intellectual property litigation (see Note 9 of Notes to Condensed Consolidated Financial Statements) and has not accrued a liability for such litigation. The Company regularly evaluates current information available to determine whether such accruals should be made. An estimated liability would be accrued when it is determined that it is probable that a material loss has been incurred and the amount of loss can be reasonably estimated. If the Company were to determine that such a material loss was probable and could be reasonably estimated, the adjustment would be charged to income in the period such determination was made.

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 September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	51.0	60.3	52.0	60.9
Gross profit	49.0	39.7	48.0	39.1
Operating expenses:				
Research and development	16.4	21.6	15.8	23.7
Selling, general and administrative	14.7	13.6	13.8	13.6
Amortization of deferred stock compensation	0.7	1.6	0.9	1.6
Purchased in-process technology	-	-	0.2	-
Manufacturing facility impairment	-	(1.2)	-	(0.4)
Restructuring expense	0.6	0.5	0.2	0.2
Total operating expenses	32.4	36.1	30.9	38.7
Income from operations	16.6	3.6	17.1	0.4
Other income, net	0.5	0.3	0.4	0.3
Income before income taxes	17.1	3.9	17.5	0.7
Provision for income taxes	6.0	0.9	4.3	0.1
Net income	11.1%	3.0%	13.2%	0.6%

Net Revenues. For the three months ended September 30, 2004, net revenues increased 27% to $67.9 million from $53.4 million for the same period in the prior year. For the nine months ended September 30, 2004, net revenues increased 29% to $198.1 million from $153.4 million for the same period in the prior year. These increases were primarily due to increased standard products revenues, which were partially offset by decreased custom and foundry products revenues.

Standard products revenues increased 36% to $65.3 million, for the three months ended September 30, 2004, from $48.2 million for the same period in the prior year. These increases resulted primarily from increased unit shipments of standard products to the telecommunications, computer, high speed communications and networking end markets. For the nine months ended September 30, 2004, standard products revenues increased 39% to $190.1 million from $137.0 for the same period in the prior year. These increases resulted primarily from increased unit shipments of standard products to the telecommunications, computer, industrial, high speed communications and networking end markets.

Custom and foundry products revenues decreased 51% to $2.5 million representing 4% of net revenues, for the three months ended September 30, 2004, from $5.2 million or 10% of net revenues for the same period in the prior year. For the nine months ended September 30, 2004, custom and foundry products revenues decreased 51% to $8.0 million from $16.4 for the same period in the prior year. The decrease resulted primarily from the cessation of low margin foundry business with a single customer, Lexmark, in the fourth quarter of 2003.

Customer demand for semiconductors can change quickly and unexpectedly. From the middle of 2001 through 2003, customers perceived that semiconductor components were readily available and ordered only for their short-term needs, resulting in historically low order backlog levels. The Company's revenue levels have been highly dependent on the amount of new orders that are received for which product is requested to be delivered to the customer within the same quarter. Within the semiconductor industry these orders that are booked and shipped within the quarter are called "turns fill" orders. When the turns fill level exceeds approximately 35% of quarterly revenue, it makes it very difficult to predict near term revenues and income. Because of the long cycle time to build its products, the Company's lack of visibility into demand when turns fill is high makes it difficult to predict what product to build to match future demand. The Company averaged approximately 55% turns fill per quarter during 2003.

The turns fill for the third quarter of 2004 remained at the same level as the second quarter, approximately 35%. After experiencing an increase in order rates and backlog in the first six months of 2004, order rates in the third quarter declined as customers quickly reduced new orders in an attempt to control their inventories in response to uncertain demand for their end products and lower supplier lead times. The Company's lead times decreased during the third quarter to less than four weeks at the end of September, compared with lead times of seven to eight weeks at the end of the second quarter. Although overall semiconductor industry channel inventories appear to be equal to or below long term historical trends, customers perceive semiconductor components are readily available. Customers are cautious in committing new orders, relying instead on short lead times and the willingness of semiconductor manufacturers to hold inventory and react quickly to supply their short term needs. The slowing of global economic growth rates, the aversion to holding inventory and the hope of negotiating lower prices has caused many customers to reduce order backlog on their suppliers. The Company's backlog at September 30, 2004 declined on a sequential basis but remains above the backlog level of September 30, 2003. The lower backlog level, increased reliance on turns fill orders, unseasonable weakness in order rates and the uncertain growth rate of the world economy make it difficult to predict near term demand. Although the Company is reducing production levels in response to lower order rates, the uncertainty in demand arising from these factors, together with the uncertainty of product mix and pricing, make it difficult to predict future levels of sales and profitability and may require the Company to continue to carry higher levels of inventory.

International sales represented 77% and 70% of net revenues for the three months ended September 30, 2004 and 2003, respectively. On a dollar basis, international sales increased 40% to $52.2 million for the three months ended September 30, 2004 from $37.2 million for the comparable period in 2003. For the nine months ended September 30, 2004 and 2003, international sales represented 76% and 69% of net revenues, respectively. On a dollar basis, international sales increased 43% to $150.9 million for the nine months ended September 30, 2004 from $105.3 million for the comparable period in 2003. These increases resulted primarily from increased shipments of telecommunications, networking communications and high speed communications products, primarily in Asia and to a lesser extent Europe.

The trend for the Company's customers to move their electronics manufacturing to Asian countries has brought increased pricing pressure for Micrel and other semiconductor manufacturers. Asian based manufacturers are typically more concerned about cost and less concerned about the capability of the integrated circuits they purchase. This can make it more difficult for United States based companies to differentiate themselves except by price. The increased concentration of electronics procurement and manufacturing in the Asia Pacific region has led, and may continue to lead, to continued price pressure for the Company's products in the future.

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 increased to 49% for the three months ended September 30, 2004 from 40% for the comparable period in 2003. For the nine months ended September 30, 2004, gross margin increased to 48% from 39% for the comparable period in 2003. These increases in gross margin resulted primarily from a greater sales mix of higher margin products, decreased wafer fabrication costs, and decreased external assembly and test costs. During the three and nine months ended September 30, 2004, the company reduced sales of low margin foundry products and increased sales of higher margin analog and high speed communications standard products as compared to the same periods in 2003. In 2004, the Company benefited from decreased wafer fabrication costs resulting from the Company's wafer fabrication consolidation project (see Note 12 of Notes to Condensed Consolidated Financial Statements) and lower costs for external assembly and test manufacturing services. The Company's gross profit margin has also benefited from spreading fixed costs over a higher sales volume. In addition, gross profit for the nine months ended September 30, 2004 includes the reversal of $1.1 million of accrued payroll tax liabilities, recorded in the second quarter of 2004, associated with the conclusion of a tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements). Depreciation and amortization (excluding amortization of deferred stock compensation) as a percent of sales has declined to 9% for the nine months ended September 20, 2004 from 14% for the same periods in 2003.

In response to the decline in order rates during the third quarter and the uncertainty of end demand, the Company is reducing its planned level of production in the fourth quarter of 2004. The Company is acting to reduce the effect on gross margin from lower factory utilization by taking a holiday shutdown and controlling expenses. Should global economic growth remain strong and demand for the Company's products rebound, the Company has the ability to rapidly increase manufacturing output.

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.

Research and development expenses represented 16% and 22% as a percentage of net revenues, for the three months ended September 30, 2004 and 2003, respectively. On a dollar basis, research and development expenses decreased $355,000 or 3% to $11.1 million for the three months ended September 30, 2004 from $11.5 million for the comparable period in 2003. For the nine months ended September 30, 2004 and 2003, research and development expenses represented 16% and 24% as a percentage of net revenues, respectively. On a dollar basis, research and development expenses decreased $4.9 million or 14% to $31.4 million for the nine months ended September 30, 2004 from $36.3 million for the comparable period in 2003. This decrease was primarily due to decreased prototype fabrication costs and the reversal of $1.7 million of accrued payroll tax liabilities in the second quarter of 2004, associated with the conclusion of a tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements). 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 15% and 14% for the three months ended September 30, 2004 and 2003, respectively. On a dollar basis, selling, general and administrative expenses increased $2.7 million or 37% to $10.0 million for the three months ended September 30, 2004 from $7.3 million for the comparable period in 2003. This dollar increase was principally attributable to increased commissions related to higher revenues, increased staffing costs and profit sharing accruals and increased outside legal costs. For the nine months ended September 30, 2004 and 2003, selling, general and administrative expenses represented 14% as a percentage of net revenues, respectively. On a dollar basis, selling, general and administrative expenses increased $6.6 million or 32% to $27.4 million for the nine months ended September 30, 2004 from $20.8 million for the comparable period in 2003. This dollar increase was principally attributable to increased commissions related to higher revenues, increased staffing costs and profit sharing accruals and increased outside legal costs which were partially offset by the reversal of $1.1 million of accrued payroll tax liabilities in the second quarter of 2004, associated with the conclusion of a tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements).

Purchased in-process technology. Associated with the acquisition of BlueChip, Micrel allocated $2.6 million of the total purchase cost to intangible assets. Of that amount, $480,000 was expensed to purchased in-process technology, which has not reached technological feasibility and has no alternative future use, in the three months ended March 31, 2004. The remaining intangible assets of $2.1 million, consisting of $1.7 million in existing technology and $450,000 in customer relationships, are included in intangible assets in the accompanying condensed consolidated balance sheets and are being amortized over their useful lives of three to five years (see Note 13 of Notes to Condensed Consolidated Financial Statements).

Other Income, Net. Other income, net reflects interest income from investments in short-term, investment-grade, securities and money market funds offset by interest expense incurred on term notes, combined with other non-operating income or expenses. Other income, net increased $213,000 to $363,000 for the three months ended September 30, 2004 from $150,000 for the comparable period in 2003. Other income, net increased $404,000 to $901,000 for the nine months ended September 30, 2004 from $497,000 for the comparable period in 2003. These increases were primarily due to increased interest income on increased cash and investment balances and decreased interest expense resulting from a decrease in average debt.

Provision for Income Taxes. The income tax provision for the three and nine months ended September 30, 2004 is based on the Company’s estimated annual effective tax rate of 35% of pretax income, reduced by a $3.8 million reversal of accrued income tax liabilities in the second quarter of 2004, as a result of the completion of a federal income tax audit (see Note 11 of Notes to Condensed Consolidated Financial Statements), and increased by $168,000 as a result of $480,000 of non-deductible purchased in-process technology charges recorded in the first quarter of 2004. For the three and nine months ended September 30, 2003, the provision for income taxes was 23% of pretax income. The income tax provision for such interim periods reflects the Company’s estimated annual income tax rate and differs from taxes computed at the federal statutory rate primarily due to the effect of state income taxes and state research and development credits.

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 September 30, 2004, consisted of cash and short-term investments of $149 million and a $5 million revolving line of credit from a commercial bank. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. There were no borrowings under the revolving line of credit at September 30, 2004 and there were $550,000 in standby letters of credit outstanding. The revolving line of credit agreement expires on June 30, 2005. Borrowings under the revolving line of credit bear interest rates of, at the Company's election, the prime rate (4.75% at September 30, 2004), or the bank's revolving offshore rate, which approximates LIBOR (2.0% at September 30, 2004) plus 2.0%. 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 September 30, 2004.

In September 2002, the Company borrowed $10.7 million through a commercial mortgage financing agreement which was associated with the purchase of its previously leased manufacturing facilities in San Jose, CA. Borrowings under this agreement bear interest, at the Company's election, at the daily floating prime rate (4.75% at September 30, 2004), or adjustable monthly LIBOR (2.0% at September 30, 2004) plus 1.5%. The principal balance of the loan is to be repaid in 59 consecutive monthly installments of $16,890 and one final installment in the amount necessary to pay in full the remaining outstanding principal balance, with no early payment penalty. In December 2003, the company repaid $7.0 million of the loan, resulting in a remaining loan balance of $3.3 million at September 30, 2004. The mortgage agreement contains certain restrictive covenants with which the Company was in compliance at September 30, 2004.

The Company generated $52.8 million in cash flows from operating activities for the nine months ended September 30, 2004 as compared to $25.9 million for the same period in the prior year. The $52.8 million in cash flows from operating activities generated by the Company, during the nine months ended September 30, 2004, were primarily attributable to net income of $26.2 million plus additions for non-cash activities of $31.7 million and a $4.7 million increase in accounts payable, which was partially offset by a $5.4 million increase in accounts receivables, as a result of increased revenues and a $5.9 million increase in inventories as a result of increased manufacturing activity and an increase in finished goods stock in an attempt to provide a high level of customer service.

The $25.9 million in cash flows from operating activities generated by the Company in the nine months ended September 30, 2003 were primarily attributable to net income of $874,000 plus additions for non-cash activities of $29.8 million combined with a $2.5 million decrease in inventory, which were partially offset by a $4.3 million decrease in income taxes payable and a $2.6 million increase in accounts receivable.

The Company used $54.9 million of cash in investing activities during the nine months ended September 30, 2004 comprised of $13.6 million in purchases of property, plant and equipment, $38.3 million in purchases of short term and long-term investments, $2.0 million for the purchase of BlueChip Communications and $1.0 million for the purchase of intangible assets. Cash used in investing activities during the nine months ended September 30, 2003 resulted from $15.8 in net purchases of property, plant and equipment.

The Company used $25.7 million of cash in financing activities during the nine months ended September 30, 2004 primarily for the repurchase of $29.0 million of the Company's common stock, which was partially offset by $3.9 million in proceeds from employee stock transactions. Cash used in financing activities during the nine months ended September 30, 2003 was $705,000 and resulted from the repurchase of $3.5 million of the Company's common stock combined with $735,000 in repayments of long-term debt, which was partially offset by $3.5 million in proceeds from employee stock transactions.

The Company currently intends to purchase approximately $18 million to $25 million in capital equipment and improvements during the next 12 months primarily for manufacturing equipment for wafer fabrication and product testing and additional research and development related software and equipment. The Company is currently authorized by its Board of Directors to repurchase an additional $46.0 million of its common stock through June 30, 2005. The Company expects that its cash requirements through 2004 will be met by its cash from operations, existing cash balances and short-term investments, and its credit facility. In the longer term, the Company believes future cash requirements will continue to be met by its cash from operations, and future debt or equity financings as required.

Recently Issued Accounting Standards

Please refer to Note 2 of Notes to Condensed Consolidate Financial Statements for a discussion of the expected impact of recently issued accounting standards.

Contractual Obligations and Commitments

The Company's contractual obligations disclosure in its Annual Report on Form 10-K for the year ended December 31, 2003 has not materially changed since that report was filed. During the nine months ended September 30, 2004 payments of $1.9 million were made under previously existing operating leases, repayments of $587,000 were made under previously existing long-term debt agreements and a $2.0 payment was made for other long-term liabilities. Open purchase orders were approximately $20 million and are all due within one year. These obligations primarily relate to future purchases of wafer fabrication raw materials, wafer fabrication masks, foundry wafers, assembly and testing services.

Borrowing agreements consisted of a $5 million revolving line of credit from a commercial bank. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. There were no borrowings under the revolving line of credit at September 30, 2004 and there were $550,000 in standby letters of credit outstanding. The letters of credit are issued to guarantee payments for the Company's workers compensation program.

The Company has no other off-balance sheet arrangements and has not entered into any transactions involving unconsolidated, limited purpose entities or commodity contracts.

Factors That May Affect Operating Results

If a company's operating results are below the expectations of public market analysts or investors, then the market price of its Common Stock could decline. Many factors that can affect a company's quarterly and annual results are difficult to control or predict. Some of the factors which can affect a multinational semiconductor business such as the Company are described below.

Geopolitical and Macroeconomic Risks That May Affect Multinational Enterprises

Demand for semiconductor components is increasingly dependent upon the rate of growth of the global economy. If the rate of global economic growth slows, or contracts, customer demand for products could be adversely affected, which in turn could negatively affect revenues, results of operations and financial condition. Many factors could adversely affect regional or global economic growth. Some of the factors that could slow global economic growth include: rising interest rates in the United States, a slowdown in the rate of growth of the Chinese economy, a significant act of terrorism which disrupts global trade or consumer confidence, geopolitical tensions including war and civil unrest. Reduced levels of economic activity, or disruptions of international transportation, could adversely affect sales on either a global basis or in specific geographic regions

The Company has generated a substantial portion of its net revenues from export sales. The Company believes that a substantial portion of its 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, acts of terrorism, social conditions such as civil unrest, 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, the Company sells to domestic customers that do business worldwide and cannot predict how the businesses of these customers may be affected by economic or political conditions elsewhere in the world. Such factors could adversely affect the Company's future revenues, financial condition, results of operations or cash flows.

The Company is reliant on certain key suppliers for wafer fabrication, circuit assembly and testing services. Most of these suppliers are based outside of the U.S. The Company's supply could be interrupted as a result of any of the previously mentioned risk factors relating to international markets.

Market conditions may lead the Company to initiate additional cost reduction plans, which may negatively affect near term operating results. Weak customer demand, competitive pricing pressures, excess capacity, weak economic conditions or other factors, may cause the Company to initiate additional actions to reduce the Company's cost structure and improve the Company's future operating results. The cost reduction actions may require incremental costs to implement, which could negatively affect the Company's operating results in periods when the incremental costs or liabilities are incurred.

The Company's international sales are denominated in U.S. currency. Changes in exchange rates that strengthen the U.S. dollar could increase the price of the Company's products in the local currencies of the foreign markets it serves. This would result in making the Company's products relatively more expensive than its 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.

The Financial Accounting Standards Board ("FASB") has issued a proposed accounting standard which would require all companies to treat the value of stock options granted to employees as an expense in the Company's Consolidated Statement of Operations. Should the proposal become effective, Micrel and other companies that have issued stock options would be required to record a compensation expense equal to the value of each stock option granted, which would negatively impact GAAP profitability. In addition, the FASB has proposed a choice of valuation models to estimate the fair value of employee stock options. These models, including the Black-Scholes and Binomial option-pricing models, use varying methods and inputs and may yield significantly different results.

The Company does not agree with the FASB proposal to treat employee stock options as compensation expense and has stated so in writing to the FASB. The Company believes that employee stock option transactions are not consistent with or comparable to other forms of employee compensation but are consistent with and comparable to an equity investment and therefore should continue to be recorded as such upon exercise. The Company believes that employee stock options do not meet that part of the legal definition of compensation as payment for services rendered, since stock options are offered as an inducement prior to service. Unlike most other employee benefits, stock options are not a controllable expense, since the Company has no control over the market value of its stock and therefore has no control over the ultimate value, if any, received by the employee. Expensing a calculated value of stock options will negatively distort the Company's financial performance in a way it cannot control unless the Company ceases to issue stock options. In addition, the estimated value of employee stock options, using option-pricing models, is currently disclosed annually and quarterly in the notes to the Company's consolidated financial statements. Therefore for those investors who are concerned about the effect of employee stock options on the Company, the effect of expensing employee stock options is already reported.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include a report of management on the Company's internal controls over financial reporting in their annual reports on Form 10-K. If the Company is unable to complete its assessment as to the adequacy of its internal controls over financial reporting as of December 31, 2004 and future year-ends as required by section 404 of the Sarbanes-Oxley act of 2002, or in the course of such assessments identify and report in Form 10-K material weaknesses in controls, investors could lose confidence in the reliability of the Company's internal control over financial reporting, which could result in a decrease in the value of its common stock.

This report is required to contain an assessment by management of the effectiveness of the Company's internal control over financial reporting. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management’s assessment of the effectiveness of a company’s internal control over financial reporting. This requirement will first apply to Micrel for the year ending December 31, 2004. Although the Company intends to diligently and vigorously review internal controls over financial reporting in order to ensure compliance with the Section 404 requirements, and has been expending significant resources in developing the necessary documentation and testing procedures required by Section 404, there is a risk that the Company may not comply with all of the requirements imposed by Section 404. If the Company fails to complete its assessment of internal controls in a timely manner, or fails to meet the requirements of Section 404, the Company's independent registered public accounting firm may issue a report that is qualified. In addition, the limited size of the Company could lead to conditions that could be considered material weaknesses, such as those related to segregation of duties that is possible in larger organizations but more difficult in smaller organizations. Also, controls related to general information technology infrastructure may not be as comprehensive as in the case of a larger organization with more sophisticated capabilities. It is not clear how such circumstances should be interpreted in the context of an assessment of internal controls over financial reporting. If the Company fails to implement required new or improved controls, it may be unable to comply with the requirements of Section 404 in a timely manner.

Semiconductor Industry Specific Risks

The volatility of customer demand in the semiconductor industry limits a company's ability to predict future levels of sales and profitability. Semiconductor suppliers can rapidly increase production output, leading to a sudden oversupply situation and a subsequent reduction in order rates and revenues as customers adjust their inventories to true demand rates. A rapid and sudden decline in customer demand for products can result in excess quantities of certain products relative to demand. Should this occur the Company’s operating results may be adversely affected as a result of charges to reduce the carrying value of the Company’s inventory to the estimated demand level or market price. The Company's quarterly revenues are highly dependent upon turns fill orders (orders booked and shipped in the same quarter). The short-term and volatile nature of customer demand makes it extremely difficult to predict near term revenues and profits.

The short lead time environment in the semiconductor industry has allowed many end consumers to rely on stocking representatives and distributors to carry inventory to meet short term requirements and minimize their investment in on-hand inventory. Since the end of 2003 some of the Company’s stocking representatives and distributors have increased their inventory levels to service the volatile short-term demand of the end customer. Should the relationship with a distributor or stocking representative be terminated, the future level of product returns could be higher than the returns allowance established, which could negatively affect the Company’s revenues and results of operations.

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 and price; timing of product introductions; emergence of new computer and communications standards; quality and customer support.

During a period when economic growth and customer demand have been less certain, both the semiconductor industry and the Company have experienced significant price erosion since the beginning of 2001. If price erosion continues, it will have the effect of reducing revenue levels and gross margins in future periods. Furthermore, the trend for the Company’s customers to move their electronics manufacturing to Asian countries has brought increased pricing pressure for Micrel and the semiconductor industry. Asian based manufacturers are typically more concerned about cost and less concerned about the capability of the integrated circuits they purchase. The increased concentration of electronics procurement and manufacturing in the Asia Pacific region may lead to continued price pressure and additional product advertising costs for the Company’s products in the future.

Customer demand for semiconductor products typically fluctuates based on seasonal patterns. Demand in the third and fourth quarter of the calendar year is typically higher due to the seasonal buying patterns related to the Christmas period. Demand in the first calendar quarter is typically lower due to the post-Christmas decline in consumption. Third quarter demand was unseasonably weak. Should actual seasonal demand patterns in the fourth quarter of 2004 be different than historical patterns, revenues and financial results may be adversely affected.

The wireless handset market comprises a significant portion of the Company's standard product revenues. Due to the highly competitive and fast changing environment in which the Company's wireless handset customers operate, demand for the product the Company sells into this end market can change rapidly and unexpectedly. If the Company's wireless handset customers lose market share, or accumulate too much inventory of completed handsets, the demand for the Company's products can decline sharply which could adversely affect the Company's revenues and results of operations.

An important part of the Company's strategy is to continue to focus on the market for high-speed communications ICs. If the recovery in the telecommunications infrastructure and wire line networking markets is not sustainable, resulting in reduced demand for the Company's high bandwidth products, the Company's future revenue growth and profitability could be adversely affected.

The markets that the Company serves frequently undergo transitions in which products rapidly incorporate new features and performance standards on an industry-wide basis. If the Company's products are unable to support the new features or performance levels required by OEMs in these markets, it 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 the Company fails to develop products with required features or performance standards, or experiences even a short delay in bringing a new product to market, or if its customers fail to achieve market acceptance of their products, its revenues could be significantly reduced for a substantial period of time.

Because the standard products market for ICs is diverse and highly fragmented, the Company encounters different competitors in various market areas. Most of these competitors have substantially greater technical, financial and marketing resources and greater name recognition than the Company. There can be no assurance that the Company 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 the Company's financial condition, results of operations, or cash flows.

The significant investment in semiconductor manufacturing capacity and the rapid growth of circuit design centers in China may present a competitive threat to established semiconductor companies due to the current low cost of labor and capital in China. The emergence of low cost competitors in China could reduce the revenues and profitability of established semiconductor manufacturers.

Many semiconductor companies face risks associated with a dependence upon third parties that manufacture, assemble or package certain of its products. These risks include reduced control over delivery schedules and quality; inadequate manufacturing yields and excessive costs; the potential lack of adequate capacity during periods of excess demand; difficulties selecting and integrating new subcontractors; potential increases in prices; disruption in supply due to civil unrest, terrorism or other events which may occur in the countries in which the subcontractors operate; and potential misappropriation of the Company's intellectual property. Any of these risks may lead to increased costs or delay delivery of the Company's products, which would harm its profitability and customer relationships. Additionally, the Company's wafer and product requirements typically represent a relatively small portion of the total production of the third-party foundries and outside assembly, testing and packaging contractors. As a result, Micrel is subject to the risk that a foundry will provide delivery or capacity priority to other larger customers at the expense of Micrel, resulting in an inadequate supply to meet customer demand or higher costs to obtain the necessary product supply.

There is intense competition for qualified personnel in the semiconductor industry, in particular design engineers. The Company may not be able to continue to attract and train engineers or other qualified personnel necessary for the development of its business or to replace engineers or other qualified personnel who may leave its 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 the Company's product and process development programs.

The success of companies in the semiconductor industry depends in part upon intellectual property, including patents, trade secrets, know-how and continuing technology innovation. There can be no assurance that the steps taken by the Company to protect its 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 the Company will not be invalidated, circumvented or challenged, that the rights granted thereunder will provide competitive advantages or that any of its pending or future patent applications will be issued with the scope of the claims sought, if at all. Furthermore, there can be no assurance that others will not develop technologies that are similar or superior to the Company's technology, duplicate technology or design around the patents owned by the Company. 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 the Company's business, financial condition, results of operations, or cash flows.

Companies in the semiconductor industry are subject to a variety of federal, state and local governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in its manufacturing process. Any failure to comply with present or future regulations could result in the imposition of fines, the suspension of production, alteration of manufacturing processes or a cessation of operations. In addition, these regulations could restrict the Company's ability to expand its facilities at their present locations or construct or operate a new wafer fabrication facility or could require the Company to acquire costly equipment or incur other significant expenses to comply with environmental regulations or clean up prior discharges. The Company's failure to appropriately control the use of, disposal or storage of, or adequately restrict the discharge of, hazardous substances could subject it to future liabilities and could have a material adverse effect on its business.

Company-Specific Risks

In addition to the risks that affect multinational semiconductor companies listed above, there are additional risks which are more specific to the Company such as:

The Company’s gross margin, operating margin and net income are highly dependent on the level of revenue and capacity utilization that the Company experiences. Semiconductor manufacturing is a capital-intensive business resulting in high fixed costs. If the Company is unable to utilize its installed wafer fabrication or test capacity at a high level, the costs associated with these facilities and equipment would not be fully absorbed, resulting in higher average unit costs and lower profit margins. The Company has increased utilization of its production capacity through the first nine months of 2004. If the decrease in customer demand experienced in the third quarter continues and production activity is reduced in response to lower demand, gross margin, operating margin and net income may deteriorate.

The Company derives a significant portion of its revenues from customers located in certain geographic regions or countries. Three of the Company’s top ten direct customers are located in South Korea. In the event that political tensions surrounding North Korea evolve into military or social conflict, or other factors disrupt the Korean economy, the Company’s revenues, results of operations, cash flow and financial condition could be adversely affected. A significant portion of the Company’s revenues come from customers located in Taiwan and China. In the event that economic activity in these two countries declines, or is disrupted by geopolitical events, the Company’s revenues and results of operations could be adversely affected.

The Company manufactures most of its semiconductors at its San Jose, California fabrication facilities. The Company's existing wafer fabrication facility, located in Northern California, may be subject to natural disasters such as earthquakes. A significant natural disaster, such as an earthquake or prolonged drought, could have a material adverse impact on the Company's business, financial condition and operating results. Furthermore, manufacturing semiconductors requires manufacturing tools that are unique to each product being produced. If one of these unique manufacturing tools was damaged or destroyed, the Company's ability to manufacture the related product would be impaired and its business would suffer until the tool was repaired or replaced. Additionally, the fabrication of ICs 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 Company maintains approximately two to three months of inventory that has completed the wafer fabrication manufacturing process. This inventory is generally located offshore at third party subcontractors and can act to buffer some of the adverse impact from a disruption to the Company’s San Jose wafer fabrication activity arising from a natural disaster such as an earthquake.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At September 30, 2004, the Company held $36.2 million in short-term investments and $2.0 million in long-term investments. Short-term and long-term investments consist primarily of liquid debt instruments and are classified as available-for-sale securities. Investments purchased with remaining maturity dates of greater than three months and less than 12 months are classified as short-term. Investments purchased with remaining maturity dates of 12 months or greater are classified as long-term. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10 percent from levels at September 30, 2004, the fair value of the short-term investments would decline by an immaterial amount. The Company generally expects to have the ability to hold its fixed income investments until maturity and therefore would not expect operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on short-term investments.

At September 30, 2004, the Company held no fixed-rate long-term debt subject to interest rate risk.

ITEM 4: CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Securities and Exchange Commission Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are effective at the reasonable assurance level.

There has been no change in the Company’s internal controls over financial reporting during the Company’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Sarbanes-Oxley Section 404 Compliance

The Securities and Exchange Commission, as directed by Section 404 of the Sarbanes-Oxley Act of 2002 (the “Act”) adopted rules requiring public companies to include a report from management on the Company’s internal control over financial reporting in Annual Reports on Form 10-K. This requirement will first apply to Micrel's Annual Report on Form 10-K for the year ending December 31, 2004 and in subsequent Annual Reports thereafter. The report from management must include the following: (1) a statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting, (2) a statement identifying the framework used by management to conduct the required evaluation of the effectiveness of the Company’s internal control over financial reporting, (3) management’s assessment of the effectiveness of the Company’s internal control over financial reporting as of December 31, 2004, including a statement as to whether or not internal control over financial reporting is effective, and (4) a statement that the Company’s independent auditors have issued an attestation report on management’s assessment of internal control over financial reporting.

Management acknowledges its responsibility for establishing and maintaining internal control over financial reporting and seeks to continually improve those controls. In order to achieve compliance with Section 404 of the Act within the required timeframe, the Company has been conducting a process to document and evaluate internal control over financial reporting over the first ten months of 2004. In this regard, the Company has dedicated internal resources, engaged temporary employees, and adopted a detailed work plan to: (i) assess and document the adequacy of its internal control over financial reporting; (ii) take steps to improve internal control processes where required; (iii) validate through testing that internal controls are functioning as documented; and (iv) implement a continuous reporting and improvement process for internal control over financial reporting. We believe the Company's process for documenting, evaluating and monitoring its internal control over financial reporting is consistent with the objectives of Section 404 of the Act.

We have prepared initial documentation of the Company's internal control over financial reporting and have recently commenced testing of those controls but have not yet completed this testing. Although the Company intends to diligently and vigorously review internal control over financial reporting, no assurance can be provided as to management's, or the Company's independent auditor’s conclusions at December 31, 2004 with respect to the effectiveness of the Company's internal control over financial reporting, or that the Company will be able to complete the required assessment in a timely manner.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information included in Note 9 of Notes to Condensed Consolidated Financial Statements under the caption "Litigation and Other Contingencies" in Item 1 of Part I is incorporated herein by reference.

ITEM 2. UNREGISTERED SALES AND USE OF PROCEEDS

Dividend Payment Restrictions

The Company has entered into borrowing agreements that contain restrictions on the declaration and payment of dividends without the lender's consent. In addition, the Company currently intends to retain future earnings to fund operations, and does not anticipate paying dividends on its common stock in the foreseeable future.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Repurchased Under the Plans or Programs ($000)
January 2004	42,550	$ 16.70	42,550	$ 8,670
February 2004	75,350	$ 15.91	75,350	$ 7,471
March 2004	167,150	$ 13.75	167,150	$ 20,792
April 2004	138,850	$ 13.11	138,850	$ 18,972
May 2004	96,600	$ 12.83	96,600	$ 17,733
June 2004	482,600	$ 13.03	482,600	$ 11,447
July 2004	501,600	$ 10.31	501,600	$ 6,274
August 2004	581,100	$ 9.44	581,100	$ 50,790
September 2004	476,100	$ 10.11	476,100	$ 45,976
Total	2,561,900	$ 11.33	2,561,900	

In February 2002, the Company's Board of Directors approved a plan to repurchase shares of the Company's common stock in the open market. Shares of common stock purchased pursuant to the repurchase program are cancelled upon repurchase, and are intended to offset dilution from the Company's stock option plans, employee stock purchase plans and 401(k) plan. The Company has previously disclosed purchase activity and amendments to this plan in its Annual and Quarterly Reports on Form 10-K and Form 10-Q in the Notes to Consolidated Financial Statements. In August, 2004 the Board of Directors amended the repurchase program and authorized the repurchase of common stock up to a maximum value of $75 million during the period from January 1, 2004 through June 30, 2005.

ITEM 6. EXHIBITS

Exhibit No.	Description
31	Certifications of the Company’s Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications of the Company’s Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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: November 8, 2004

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

EXHIBIT 31

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Raymond D. Zinn, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Micrel, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2004 By /s/ Raymond D. Zinn
Raymond D. Zinn
President, Chief Executive Officer and Director
(Principal Executive Officer)

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Richard D. Crowley, Jr. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Micrel, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2004

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

EXHIBIT 32

Certification of Chief Executive Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Micrel, Incorporated (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 8, 2004

/s/ Raymond D. Zinn
Raymond D. Zinn
Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Micrel, Incorporated (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 8, 2004

/s/ Richard D. Crowley
Richard D. Crowley
Chief Financial Officer