## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis of financial condition and results of operations should be read in conjunction with the Company's consolidated financial statements and accompanying notes included in Item 8. "Financial Statements and Supplementary Data."

### Cautionary Statement

The statements in this Management's Discussion and Analysis that are forward looking involve numerous risks and uncertainties and are based on current expectations. The reader should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including those risks discussed under "Factors Affecting Future Results" and elsewhere in this document. Forward looking statements can often be identified by the use of forward looking words, such as "may," "will," "could," "should," "expect," "believe," "anticipate," "estimate," "continue," "plan," "intend," "project," or other similar words.

### Nature of Operations

Xilinx designs, develops and markets complete programmable logic solutions, including advanced ICs, software design tools, predefined system functions delivered as IP cores, design services, customer training, field engineering and technical support. Our PLDs include FPGAs and CPLDs. These devices are standard products that our customers program to perform desired logic functions. Our products are designed to provide high integration and quick time-to-market for electronic equipment manufacturers primarily in the communications, storage, server, consumer, industrial and other markets. We sell our products globally through independent domestic and foreign distributors, through direct sales to OEMs by a network of independent sales representative firms and through a direct sales management organization.

### Critical Accounting Policies and Estimates

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The U.S. Securities and Exchange Commission (SEC) has defined critical accounting policies as those that are most important to the portrayal of our financial condition and results of operations and require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our critical policies include: valuation of financial instruments, which impacts gains (losses) on equity securities when we record impairments; revenue recognition, which impacts the recording of revenues; valuation of inventories, which impacts cost of revenues and gross margin; the assessment of impairment of long-lived assets including goodwill and other intangible assets, which impacts their valuation, and accounting for income taxes, which impacts the provision (benefit) recognized for income taxes, as well as the classification and valuation of deferred tax assets and liabilities recorded on our consolidated balance sheet. Below, we discuss these policies further, as well as the estimates and judgments involved. We also have other key accounting policies that are not as subjective, and therefore, their application would not require us to make estimates or judgments that are as difficult.

*Valuation of Financial Instruments*

The Company's short-term and long-term investments include marketable and non-marketable equity and debt securities. At April 3, 2004, the Company had an equity investment in UMC, a public Taiwanese semiconductor wafer manufacturing company, of $324.0 million and strategic investments in non-marketable equity securities of $22.9 million. In determining if and when a decline in market value below cost of these investments is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings, price multiples, and other key measures for our investments. When a decline in value is deemed to be other-than-temporary, the Company recognizes an impairment loss in the current period operating results to the extent of the decline.

*Revenue Recognition*

Sales to distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to customers. Revenue recognition depends on notification from the distributor that product has been sold to the end customer. Reported information includes product resale price, quantity and end customer shipment information, as well as inventory on hand. Distributor inventory on hand is reconciled to deferred revenue balances monthly. Xilinx maintains system controls to validate the data and verify that the reported information is accurate. The effects of distributor price adjustments are recorded as a reduction to deferred income on shipments to distributors reflecting the amount of gross margin expected to be realized when distributors sell through product purchased from Xilinx. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from Xilinx at which point we have a legally enforceable right to collection under normal payment terms.

Revenue from sales to our direct customers is recognized upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements and there are no remaining significant obligations. For each of the periods presented, there were no formal acceptance provisions with our direct customers.

Revenue from software term licenses is deferred and recognized as revenue over the term of the licenses of one year. Revenue from support services is recognized when the service is provided. Revenue from support products, which includes software and services sales, was less than 10% of net revenues for all of the periods presented.

Allowances for end customer sales returns are recorded based on historical experience and for known pending customer returns or allowances.



*Valuation of Inventories*

Inventories are stated at the lower of cost (determined using the first-in, first-out method) or market (estimated net realizable value). The Company reviews and sets standard costs quarterly at current manufacturing costs. The Company's manufacturing overhead standards for product costs are calculated assuming full absorption of forecasted spending over projected volumes. Given the cyclicality of the market, the obsolescence of technology and product life cycles, the Company writes down inventory based on backlog, forecasted demand and technological obsolescence. These factors are impacted by market and economic conditions, technology changes, new product introductions and changes in strategic direction and require estimates that may include uncertain elements. In addition, backlog is subject to revisions, cancellations and rescheduling. Actual demand may differ from forecasted demand and such differences may have a material effect on the Company's gross margins.

*Impairment of Long-Lived Assets Including Goodwill and Other Intangibles*

We adopted SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS 142) effective the beginning of the first quarter of fiscal 2003. Accordingly, for fiscal 2003 and future years, we no longer amortized goodwill from acquisitions, but we continued to amortize other acquisition-related intangibles. We expect amortization of other intangibles to be approximately $5.0 million for fiscal 2005 compared with $9.8 million for fiscal 2004 and down from $15.3 million of amortization of goodwill and other acquisition related intangibles in fiscal 2003.

At April 3, 2004, the net book value of acquisition related intangibles totaled $128.4 million, comprised of unamortized goodwill of $111.6 million and other acquisition related intangibles of $16.8 million. We completed the annual goodwill impairment review during the fourth quarter of fiscal 2004, and found no impairment. Unless there are indicators of impairment, our next impairment review will be completed in the fourth quarter of fiscal 2005. To date, no impairment indicators have been identified.

We are required to test goodwill for impairment at the reporting unit level for which purpose we have previously determined that we operate in one reportable segment containing one reporting unit. If we fail

to deliver new products, if the products fail to gain expected market acceptance, or if market conditions fail to continue to improve, our revenue and cost forecasts may not be achieved, and we may incur charges for impairment of goodwill. We also consider whether long-lived assets are impaired. When indicators of impairment exist and assets are held for use, we estimate future undiscounted cash flows attributable to the assets. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their estimated fair values based on the expected discounted future cash flows attributable to the assets. When assets are removed from operations and held for sale, we estimate impairment losses as the excess of the carrying value of the assets over their fair value. Factors affecting impairment of assets held for use include the overall profitability of the Company's business and our ability to generate positive cash flows. Changes in any of these factors could necessitate impairment recognition in future periods for assets held for use or assets held for sale.

*Accounting for Income Taxes*

Xilinx is a multinational corporation operating in multiple tax jurisdictions. Xilinx must determine the allocation of income to each of these jurisdictions based on estimates and assumptions, and apply the appropriate tax rates for these jurisdictions. Xilinx undergoes routine audits by taxing authorities regarding the timing and amount of deductions and the allocation of income among various tax jurisdictions. Tax audits often require an extended period of time to resolve and may result in income tax adjustments if changes to the allocation are required between jurisdictions with different tax rates.

In determining income for financial statement purposes, we must make certain estimates and judgments. These estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. Additionally, we must estimate the amount and likelihood of potential losses arising from audits or deficiency notices issued by taxing authorities. The taxing authorities' positions and our assessment can change over time resulting in material impacts on the provision for income taxes in periods where these changes occur.

We must also assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a reserve, in the form of a valuation allowance, for the deferred tax assets that we estimate will not ultimately be recoverable. As of April 3, 2004, we believe that all of our recorded deferred tax assets will ultimately be recovered. However, should there be a change in our ability to recover our deferred tax assets, our tax provision would increase in the period in which we determine that it is "more likely than not," under the provisions of SFAS 109, "Accounting for Income Taxes," that the tax benefit associated with the deferred tax assets will not be realized.

**Results of Operations**

The following table summarizes the results of Xilinx's operations as a percentage of net revenues for the three years ended April 3, 2004:

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| **Net Revenues** | **100.0%** | **100.0%** | **100.0%** |
| **Gross Margin** | **62.1** | **59.0** | **45.1** |
| Research and development | 17.7 | 19.2 | 20.2 |
| Selling, general and administrative | 19.1 | 20.4 | 22.5 |
| Amortization of goodwill (through fiscal 2002) and other intangibles | 0.7 | 1.2 | 4.2 |
| Impairment loss | 0.2 | 4.7 | 2.5 |
| Litigation settlement and contingency | 0.5 | 0.0 | (1.9) |
| Acquired in-process R&D | 0.5 | 0.0 | 0.0 |
| **Operating Income (Loss)** | **23.4** | **13.5** | **(2.4)** |
| Interest income and other, net, and impairment loss on investments | 1.7 | 1.2 | (16.6) |
| Provision (benefit) for income taxes | 3.4 | 3.8 | (7.8) |
| **Net Income (Loss)** | **21.7%** | **10.9%** | **(11.2)%** |

**Net Revenues**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Net revenues | $1,397,846 | 21% | $1,155,977 | 14% | $1,015,579 |

We classify our product offerings into four categories: New, Mainstream, Base and Support Products. These product categories, excluding Support Products, are adjusted on a periodic basis to better reflect advances in technology. The most recent adjustment was on March 30, 2003, which was the beginning of our fiscal 2004. Amounts for the prior periods presented have been reclassified to conform to this latest categorization. New Products include our most recent product offerings and include the Spartan-IIE, Spartan-3, Virtex-II, Virtex-II Pro, Virtex-II EasyPath and CoolRunner-II product lines. Mainstream Products include the XC4000XL, XC4000XLA, XC4000XV, Spartan-II, SpartanXL, XC9500XL, XC9500XV, CoolRunner, Virtex-E and Virtex product lines. Base Products consist of our mature product families and include the XC3000, XC3100, XC4000, XC5200, XC9500, XC4000E, XC4000EX and Spartan families. Support Products make up the remainder of our product offerings and include configuration solutions (serial PROMs), software, IP cores, customer training, design services and support.

Xilinx's net revenues increased 21% in fiscal 2004 compared to fiscal 2003. The increase was primarily due to strong customer demand for our New Products and continued growth in our Consumer, Industrial and Other end market segment. Xilinx's net revenues increased 14% in fiscal 2003 compared to fiscal 2002. The increase was primarily due to the growth in the Storage and Consumer, Industrial and Other market segments.

***Net Revenues by Product***

Net revenues by product categories for the three years ended April 3, 2004 were as follows:

| | 2004 | % of Total | % Change | 2003 | % of Total | % Change | 2002 | % of Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In millions) | | | | |
| New Products | $ 450.6 | 32 | 92 | $ 235.1 | 20 | 300 | $ 58.9 | 6 |
| Mainstream Products | 688.5 | 49 | 0 | 689.3 | 60 | 2 | 676.2 | 67 |
| Base Products | 162.4 | 12 | 1 | 160.5 | 14 | (23) | 207.3 | 20 |
| Support Products | 96.3 | 7 | 35 | 71.1 | 6 | (3) | 73.2 | 7 |
| Total Net Revenues | $1,397.8 | 100 | 21 | $1,156.0 | 100 | 14 | $1,015.6 | 100 |

The increase in revenues of New Products for both fiscal 2004 and 2003 compared to their respective prior fiscal years was due to the strong market acceptance of these products across a broad base of end markets including storage, communications and consumer-based applications.

The improved market conditions in the second half of fiscal 2004 were not enough to offset weakness in the first half of 2004 thus leading to relatively flat performance for Mainstream Products compared to fiscal 2003. After an economic downturn in fiscal 2002, a gradual improvement led to small growth in fiscal 2003 for Mainstream Products.

The small revenue growth in Base Products from fiscal 2003 to fiscal 2004 was due to improved market conditions. Revenue decline in Base Products in fiscal 2003 compared to fiscal 2002 was mainly due to the weak overall economic environment. Lastly, both configuration solutions (serial PROMs) and software contributed to the strong fiscal 2004 for Support Products compared to 2003.

In order to compete effectively, we pass manufacturing cost reductions on to our customers in the form of reduced prices to the extent that we can maintain acceptable margins. Price erosion is common in the semiconductor industry, as advances in both product architecture and manufacturing process technology permit continual reductions in unit cost. We have historically been able to offset much of the revenue decline in our mature products with increased revenues from newer products.

***Net Revenues by Geography***

Net revenues by geography for the three years ended April 3, 2004 were as follows:

| | 2004 | % of Total | % Change | 2003 | % of Total | % Change | 2002 | % of Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In millions) | | | | |
| North America | $ 592.5 | 42 | 6 | $ 559.0 | 48 | 7 | $ 524.2 | 52 |
| Europe | 270.3 | 19 | 6 | 254.3 | 22 | 8 | 235.9 | 23 |
| Japan | 203.6 | 15 | 15 | 176.4 | 15 | 35 | 130.6 | 13 |
| APAC/ROW | 331.4 | 24 | 99 | 166.3 | 15 | 33 | 124.9 | 12 |
| Total Net Revenues | $1,397.8 | 100 | 21 | $1,156.0 | 100 | 14 | $1,015.6 | 100 |

The improvement of North America revenue in fiscal 2004 compared to 2003 was primarily due to the growth in the Communications and Storage and Servers markets, which benefited from an improved economy and healthier end market demand.

International revenues grew 35% and 21% in fiscal 2004 and 2003, respectively, and represented approximately 58%, 52% and 48% of total net revenues for fiscal years 2004, 2003 and 2002, respectively. Europe grew in fiscal 2004 compared to fiscal 2003 primarily due to strength in industrial, automotive and wireless communication applications. Japan and Asia Pacific/Rest of World (APAC/ROW) grew in fiscal 2004 compared to fiscal 2003 mainly due to consumer-based applications. APAC/ROW also benefited from the transfer of manufacturing by North American and European OEMs to Asia Pacific.

North America, Europe, Japan, and APAC/ROW all experienced revenue increases in fiscal 2003 as compared to fiscal 2002 due to the strength in the storage and consumer sectors. APAC/ROW revenue increase also benefited from the transfer of manufacturing by North American OEMs to Asia.

*Net Revenues by End Markets*

Our end market revenue data is derived from our understanding of our end customers' primary markets. We classify our revenue by end market in three categories: Communications; Storage and Servers; and Consumer, Industrial and Other. Net revenues by end markets for the three years ended April 3, 2004 were as follows:

| | 2004 | % Change | 2003 | % Change | 2002 |
|---|---|---|---|---|---|
| | (% of total net revenues) | | | | |
| Communications | 50% | 12 | 55% | (11) | 70% |
| Storage and Servers | 19 | 5 | 21 | 36 | 18 |
| Consumer, Industrial and Other | 31 | 56 | 24 | 121 | 12 |
| Total Net Revenues | 100% | 21 | 100% | 14 | 100% |

In the latter part of fiscal 2004, the Communications market began to recover driven by wireless and networking applications. The decline in fiscal 2003 compared to fiscal 2002 reflects overall economic decline. Storage and Servers revenues increased in fiscal 2004 and 2003 compared to their respective prior fiscal years largely due to several customer designs entering production. Storage and Servers business as a percentage of total revenues is expected to decline going forward as the other end markets gain strength and several large customer programs migrate to newer products. The strong growth in the Consumer, Industrial and Other in fiscal 2004 and 2003 compared to their respective prior fiscal years was due to increasing acceptance of programmable logic solutions in digital consumer, defense, instrumentation and automotive applications.

**Gross Margin**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Gross margin | $867,878 | 27% | $682,426 | 49% | $457,695 |
| Percentage of net revenues | 62.1% | | 59.0% | | 45.1% |

The gross margin improvements in fiscal 2004 compared to 2003, and 2003 compared to 2002 was largely due to higher revenue, improved yields and lower manufacturing costs due to the migration to 300-milimeter wafer production.

Gross margin may be adversely affected in the future due to product mix shifts, competitive pricing pressure, manufacturing yield issues and wafer pricing. We expect to mitigate this risk by migrating wafer technology from 200-milimeter to 300-milimeter, developing 90-nanometer process technology and improving yields.

Sales of inventory previously written off were not material during fiscal 2004, 2003 or 2002.

**Research and Development**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Research and development | $247,609 | 12% | $222,139 | 9% | $204,752 |
| Percentage of net revenues | 17.7% | | 19.1% | | 20.2% |

Research and development (R&D) expenses for fiscal 2004, 2003 and 2002 include non-cash deferred stock compensation of $3.8 million, $6.4 million and $8.5 million, respectively, associated with the November 2000 acquisition of RocketChips. The increase in R&D expenses from fiscal 2003 to 2004 was primarily related to process technology and development of next generation products. The increase in R&D expenses from fiscal 2002 to 2003 was primarily related to process development of new products, an increase in employee compensation expenses from reinstatement of full pay for fiscal 2003 and profit sharing expenses.

We will continue to invest in R&D efforts in a wide variety of areas such as 90-nanometer and more advanced process technologies, IP cores and the development of new design and layout software.

**Selling, General and Administrative**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Selling, general and administrative | $266,664 | 13% | $235,347 | 3% | $228,759 |
| Percentage of net revenues | 19.1% | | 20.4% | | 22.5% |

The increase in SG&A expenses from fiscal 2003 to 2004 was primarily related to increased commissions associated with higher revenues, expenses related to increased sales resources in key markets and increased marketing activities. The increase in SG&A expenses from fiscal 2002 to 2003 was primarily related to higher sales commissions, higher employee compensation expenses due to the reinstatement of full pay for fiscal 2003 and profit sharing expenses, partially offset by a reduction in legal expenses due to the settlement of the Altera litigation in July 2001 (see "Altera Corporation Lawsuit Settlement" in this Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations).

**Amortization of Goodwill and Other Intangibles**

Amortization expense for all intangible assets for fiscal 2004, 2003 and 2002 was $9.8 million, $15.3 million and $49.0 million, respectively. Of these amounts, $9.6 million, $14.6 million and $43.0 million for fiscal 2004, 2003 and 2002, respectively, related to the RocketChips acquisition and the remaining amounts related to other technology acquisitions. Amortization expense for these intangible assets has declined due to the complete amortization of certain intangibles associated with the RocketChips' acquisition and the cessation of goodwill amortization after fiscal 2002.

Goodwill and acquired intangibles were amortized through fiscal year 2002 using an estimated useful life of four to seven years. Under the provisions of SFAS 142, as of the beginning of fiscal 2003, we no longer amortized goodwill which instead is subject to periodic impairment tests, but we continued to amortize other intangible assets.

**Impairment Losses**

The impairment loss on excess facilities and equipment recognized during the third quarter of fiscal 2003 of $54.7 million related primarily to excess facilities owned in San Jose, California. The Company lost a potential long-term arrangement to lease the facilities during the third quarter of fiscal 2003, leaving the Company with no near-term leasing alternatives or prospects for sale. The amount of the impairment was based on management's evaluation of future cash flows and an independent appraisal obtained during the third quarter of fiscal 2003.

During the third quarter of fiscal 2004, the Company received a purchase offer from a prospective buyer for an amount less than the facilities' net book value of $35.4 million. In accordance with the provisions of SFAS 144, an additional impairment charge of $3.4 million was recognized in the third quarter of fiscal 2004. During the fourth quarter of fiscal 2004, the Company sold the facilities for $33.8 million ($32.0 million, net of selling costs), resulting in no additional loss or gain.

The impairment loss on investments of $10.4 million and $4.3 million recognized during fiscal years 2003 and 2002, respectively, related to non-marketable equity securities in private companies. Of the $4.3 million of impairment losses on investments in fiscal 2002, $2.8 million is separately disclosed and $1.5 million was included in research and development expenses on the Company's consolidated statements of operations.

We recognized an impairment loss on intangible assets and equipment of $25.3 million during the second quarter of fiscal 2002 consisting of $14.9 million relating to goodwill and other intangible assets associated with a number of technology acquisitions completed during fiscal 2001 and 2000 and $10.4 million for the write-down of excess testers that were acquired in anticipation of higher unit growth.

**Write-Off of Acquired In-Process Research and Development**

In connection with the acquisition of Triscend in fiscal 2004, approximately $7.0 million of in-process research and development costs were written off. The projects identified as in-process would have required additional effort in order to establish technological feasibility. These projects had identifiable technological

risk factors that indicated that even though successful completion was expected, it was not assured. If an identified project is not successfully completed, there is no alternative future use for the project and the expected future income will not be realized. The acquired in-process research and development represented the fair value of technologies in the development stage that had not yet reached technological feasibility and did not have alternative future uses.

The acquired in-process research and development components consist of a graphical user interface and design implementation software. We do not plan to sell or provide these products to Xilinx or Triscend customers, however they will be integrated into Xilinx's product set. These products were approximately 60% complete at the time of acquisition. We expect to complete the development project by the end of fiscal 2005 with an estimated cost to complete of $2 million.

To determine the value of the in-process research and development, the expected future cash flow attributable to the in-process technology was discounted, taking into account the percentage of completion, utilization of pre-existing "core" technology, risks related to the characteristics and applications of the technology, existing and future markets, and technological risk associated with completing the development of the technology. We expensed these non-recurring charges in the period of acquisition. See Note 14 to our consolidated financial statements included in Item 8. "Financial Statements and Supplementary Data."

**Investment in United Microelectronics Corporation**

In September 1995, Xilinx, UMC and other parties entered into a joint venture to construct a wafer fabrication facility in Taiwan, known as USIC. The Company made a total cumulative cash investment of $107.1 million in USIC. The investment entitled Xilinx to receive up to 31.25% of USIC's wafer capacity.

In January 2000, USIC merged into UMC and Xilinx's equity position in USIC converted into shares of UMC, which are publicly traded on the Taiwan Stock Exchange. As a result of this merger, we received approximately 222 million shares of UMC common stock, which represent approximately 2% of the combined UMC Group, and we recognized a non-cash gain of $674.7 million ($398.1 million net of taxes) in fiscal 2000. Since the merger, Xilinx has received a total of approximately 145 million UMC shares in four separate annual stock dividend distributions increasing our investment holdings to approximately 367 million shares. We retain wafer capacity rights in UMC equivalent to those we previously had in USIC, so long as we retain a certain percentage of our original UMC shares. If our holdings fall below the specified level, our wafer capacity rights would be prorated in accordance with the UMC shares we hold.

Restrictions on the sale of these shares, imposed by UMC and the Taiwan Stock Exchange, began to expire in July 2000 and fully expired in January 2004. As of April 3, 2004, the entire UMC investment was unrestricted.

We account for our investment in UMC as available-for-sale marketable securities in accordance with SFAS 115, "Accounting for Certain Debt and Equity Securities." At March 29, 2003, the restricted portion of the investment in UMC was accounted for as a cost method investment.

The fair value of our UMC shares declined to $239.0 million as of September 29, 2001. Because of the continued downturn in the global economy, in general, and in the technology sector in particular, we believed that the decline in the market value of our investment in UMC as of September 29, 2001 was other than temporary. Accordingly, during this second quarter of fiscal 2002, we recognized a pre-tax impairment loss on our investment in UMC of $191.9 million ($113.2 million, net of tax) to reflect this other-than-temporary decline in market value. The fair value of our unrestricted UMC shares subsequently increased by $141.4 million during the third and fourth quarters of fiscal 2002, increasing the total value of our UMC investment to $380.4 million at March 30, 2002. Under the provisions of SFAS 115, we increased the value of the UMC investment by $141.4 million, recognized deferred tax liabilities of $58.0 million and increased accumulated other comprehensive income by $83.4 million.

At March 29, 2003, our equity investment in UMC shares was valued at $209.3 million on the Company's consolidated balance sheet reflecting a $171.1 million decrease in value during fiscal 2003. Under SFAS 115, we decreased the value of our UMC investment by $171.1 million, recognized a deferred tax benefit of $70.2 million and decreased accumulated other comprehensive income (loss) by $100.9 million. As of March 29, 2003, the market value of our total UMC investment was $29.7 million below its adjusted

cost of $239.0 million. We deemed the decline in value of our total investment in UMC to be temporary in nature.

The following table summarizes the cost basis and carrying values of the restricted and unrestricted portions of our investment in UMC:

| | April 3, 2004 | | March 29, 2003 | |
|---|---|---|---|---|
| | Adjusted Cost | Carrying Value | Adjusted Cost | Carrying Value |
| | (In millions) | | | |
| Unrestricted investment | $239.0 | $324.0 | $208.9 | $179.2 |
| Restricted investment | — | — | 30.1 | 30.1 |
| Total | $239.0 | $324.0 | $239.0 | $209.3 |

Under SFAS 115, since March 29, 2003, we have increased the value of our UMC investment by $114.7 million, recognized a deferred tax liability of $47.0 million and increased accumulated other comprehensive income by $67.7 million.

**Altera Corporation Lawsuit Settlement**

On July 18, 2001, the Company settled all of its outstanding patent litigation with Altera, under which Altera paid Xilinx $20 million and both parties exchanged limited patent licenses and executed agreements not to sue under any patent for at least five years. During fiscal 2002 we recorded the lawsuit settlement received of $19.4 million, net of settlement costs of approximately $600 thousand.

**Interest Income and Other, Net**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Interest income and other, net | $23,409 | (5)% | $24,628 | (7)% | $26,473 |
| Percentage of net revenues | 1.7% | | 2.1% | | 2.6% |

The decrease from fiscal 2003 to 2004 was primarily due to miscellaneous items of other income, net. Additionally, lower interest rates in fiscal 2004 largely offset the benefit of higher average cash and investment balances compared to the prior year. The decrease from fiscal 2002 to 2003 was primarily due to a reduction in capital gains recognized and lower interest rates in fiscal 2003 compared to the prior year. The amount of interest income and other, net in the future will continue to be impacted by the level of our average cash and investment balances, prevailing interest rates, and foreign currency exchange rates.

**Provision (Benefit) for Income Taxes**

| | 2004 | Change | 2003 | Change | 2002 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Provision (benefit) for income taxes | $47,555 | 8% | $44,167 | N/A | $(79,347) |
| Effective tax rate | 13.6% | | 26.0% | | 41.1% |

The effective tax rates in all years reflect the impact of foreign income/loss at different rates and tax credits earned in the United States. The fiscal year 2004 effective tax rate reflects the one-time benefit for reversing previously accrued reserves for an IRS audit that disputed the calculation of royalty payments that the Company's Ireland subsidiary paid to license the Company's technology. The IRS agreed to a stipulation in April 2004 concurring with the Company's original royalty calculations. The increase in the Company's fiscal year 2002 effective tax rate resulted from one-time write-offs of impaired assets that were not deductible for tax purposes, and the amortization of nondeductible goodwill.

The Company filed petitions with the U.S. Tax Court on March 26, 2001 and January 14, 2003 in response to assertions by the IRS that the Company owed additional tax for fiscal years 1996 through 1999. The Company filed a petition with the U.S. Tax Court on January 16, 2004, in response to assertions by the IRS that the Company owed additional tax for fiscal year 2000. See Note 11 to our consolidated financial statements, included in Item 8. "Financial Statements and Supplementary Data."

**Financial Condition, Liquidity and Capital Resources**

We have historically used a combination of cash flows from operations and equity and debt financing to support ongoing business activities, acquire critical technologies and make investments in complementary technologies, purchase facilities and capital equipment, repurchase our Common Stock under our stock repurchase program and finance working capital. Additionally, our investment in UMC is available for future sale.

**Fiscal 2004 Compared to Fiscal 2003**

*Cash, Cash Equivalents and Short-term and Long-term Investments*

The combination of cash and cash equivalents and short-term and long-term investments at April 3, 2004 totaled $1.6 billion compared with $1.1 billion at March 29, 2003.

We generated positive cash flows from operations during fiscal 2004. As of April 3, 2004, we had cash, cash equivalents and short-term investments of $799 million and working capital of $920.4 million. Cash provided by operations of $432.5 million for fiscal 2004 was $87.5 million higher than the $345.0 million generated during fiscal 2003. Increases in cash generated by operations resulted primarily from net income adjusted for non-cash related items, and increases in accounts payable and deferred income on shipments to distributors, which were partially offset by an increase in accounts receivable.

Net cash used in investing activities of $354.8 million during fiscal 2004 included net purchases of available-for-sale securities of $325.8 million, $41.0 million for purchases of property, plant and equipment and $20.0 million for the acquisition of Triscend, net of cash acquired, partially offset by $32.0 million of proceeds from the sale of buildings and land.

Net cash provided by financing activities was $45.6 million in fiscal 2004 and consisted of $108.0 million of proceeds from the issuance of common stock under employee stock plans, partially offset by $62.3 million for the acquisition of treasury stock.

*Accounts Receivable*

Accounts receivable, net of allowances for doubtful accounts, customer returns and distributor pricing adjustments increased 25.9% from $197.7 million at the end of fiscal 2003 to $249.0 million at the end of fiscal 2004. The increase was primarily attributable to the increased level of revenue and an increase in shipments late in the year.

*Inventories*

Inventories decreased from $111.5 million at March 29, 2003 to $102.5 million at April 3, 2004 due to an increased demand for new products, and our continued focus on supply chain management.

We attempt to maintain sufficient levels of inventory in various product, package and speed configurations in order to keep lead times short and to meet forecasted customer demand. Conversely, we also attempt to minimize the handling costs associated with maintaining higher inventory levels and to fully realize the opportunities for cost reductions associated with architecture and manufacturing process advancements. We continually strive to balance these two objectives to provide excellent customer response at a competitive cost.

*Property, Plant and Equipment*

During 2004, we invested $41.0 million in property, plant and equipment compared to $46.0 million in 2003. Primary investments in fiscal 2004 were for test equipment, computer equipment, IT equipment and software. Software investments included additional enterprise resource planning software functionality and automation of critical business processes.

During the fourth quarter of fiscal 2004, we sold excess facilities consisting of two buildings and land near downtown San Jose, California for $33.8 million ($32.0 million, net of selling costs). After recognizing previous impairment losses on these excess facilities of $53.8 million in fiscal 2003 and $3.4 million in fiscal 2004, there was no gain or loss on the sale of the buildings and land.

*Current Liabilities*

Current liabilities increased from $313.8 million at the end of fiscal 2003 to $381.1 million at the end of fiscal 2004. The increase was primarily attributable to the increase in accounts payable and deferred income on shipments to distributors. The increase in accounts payable was a result of increased purchases and the increase in deferred income on shipments to distributors was due to increased inventory levels at distributors, related to higher revenue levels in 2004 compared to 2003 and an increase in shipments to distributors later in the year.

*Stockholders' Equity*

Stockholders' equity increased $532.3 million during fiscal 2004, principally as a result of $303.0 million in net income for the year ended April 3, 2004, the issuance of common stock under employee stock plans of $109.2 million, $3.8 million in amortization of deferred compensation related to the RocketChips acquisition, the related tax benefits associated with stock option exercises and the employee stock purchase plan and cumulative translation adjustment totaling $110.7 million and by $68.4 million in unrealized gains on available-for-sale securities, net of deferred taxes, primarily from our investment in UMC stock. The increases were partially offset by the acquisition of treasury stock of $62.8 million.

**Fiscal 2003 Compared to Fiscal 2002**

*Cash, Cash Equivalents and Short-term and Long-term Investments*

The combination of cash and cash equivalents and short-term and long-term investments at March 29, 2003 totaled $1.1 billion compared with $799 million at March 30, 2002.

We generated positive cash flows from operations during fiscal 2003. As of March 29, 2003, we had cash, cash equivalents and short-term investments of $675.6 million and working capital of $861.4 million. Cash provided by operations of $345.0 million for fiscal 2003 was $64.1 million higher than the $280.9 million generated during fiscal 2002. Increases in cash generated by operations resulted primarily from net income adjusted for receipt of federal income tax refunds of approximately $74.1 million and an increase in deferred income on shipments to distributors, which were partially offset by an increase in accounts receivable.

During fiscal 2003, net cash used in investing activities of $355.1 million included net purchases of available-for-sale securities of $315.6 million and $46.0 million of property, plant and equipment purchases partially offset by $6.5 million of proceeds from the sale of a building.

For fiscal 2003, net cash used in financing activities of $6.2 million included $60.8 million for the acquisition of treasury stock, partially offset by $54.6 million of proceeds from the issuance of common stock under employee stock plans.

*Accounts Receivable*

Accounts receivable, net of allowances for doubtful accounts, customer returns and distributor pricing adjustments increased 33.2% from $148.4 million at the end of fiscal 2002 to $197.7 million at the end of fiscal 2003. The increase was primarily attributable to the increased level of revenue and an increase in shipments late in the year, which were reflected in the higher levels of inventory at our distributors.

*Inventories*

Inventories increased from $79.3 million at March 30, 2002 to $111.5 million at March 29, 2003 due to an increased demand for new products, which led to higher levels of inventory production.

*Property, Plant and Equipment*

During 2003, we invested $46.0 million in property, plant and equipment compared to $94.9 million in 2002. Primary investments in fiscal 2003 were for building expansion, enterprise resources planning software and computer and IT equipment.

*Current Liabilities*

Current liabilities increased from $195.8 million at the end of fiscal 2002 to $313.8 million at the end of fiscal 2003. The increase was primarily attributable to the increase in income taxes payable and deferred income on shipments to distributors. The increase in income taxes payable was a result of higher taxable income and the increase in deferred income on shipments to distributors was due to increased inventory levels at distributors, related to higher revenue levels in 2003 compared to 2002.

*Stockholders' Equity*

Stockholders' equity increased $47.0 million during fiscal 2003, principally as a result of $125.7 million in net income for the year ended March 31, 2003, the issuance of common stock under employee stock plans of $54.6 million, $6.4 million in amortization of deferred compensation related to the RocketChips acquisition, and the related tax benefits associated with stock option exercises and the employee stock purchase plan and cumulative translation adjustment totaling $18.3 million. The increases were partially offset by $97.6 million in unrealized losses on available-for-sale securities, net of deferred taxes, primarily from our investment in UMC stock and the acquisition of treasury stock of $60.4 million.

**Contractual Obligations**

The following table summarizes our significant contractual obligations at April 3, 2004 and the effect such obligations are expected to have on our liquidity and cash flows in future periods. This table excludes amounts already recorded on our balance sheet as current liabilities at April 3, 2004.

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| | | | (In millions) | | |
| Operating lease obligations(1) | $ 19.8 | $ 5.7 | $6.9 | $4.0 | $3.2 |
| Inventory and other purchase obligations(2) | 97.0 | 97.0 | — | — | — |
| Total | $116.8 | $102.7 | $6.9 | $4.0 | $3.2 |

(1) We lease some of our facilities and office buildings under operating leases that expire at various dates through December 2014. Rent expense under all operating leases was approximately $4.6 million for 2004.

(2) Due to the nature of our business, we depend entirely upon subcontractors to manufacture our silicon wafers and provide assembly and some test services. The lengthy subcontractor lead times require us to order the materials and services in advance, and we are obligated to pay for the materials and services when completed. We expect to receive and pay for the materials and services in the next three to six months.

**Off-Balance-Sheet Arrangements**

As of April 3, 2004, we did not have any significant off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Summary of Liquidity and Capital Resources**

On April 22, 2004, the Board of Directors declared our first quarterly common stock dividend, of $0.05 per share, which is payable on June 2, 2004 to stockholders of record at the close of business on May 12, 2004. Our dividend policy is impacted by, among other items, our views on potential future capital requirements relating to research and development, investments and acquisitions, legal risks, stock repurchase programs and other strategic investments.

We anticipate that existing sources of liquidity and cash flows from operations will be sufficient to satisfy our cash needs for the foreseeable future. However, the risk factors discussed below could affect our cash positions adversely. We will continue to evaluate opportunities for investments to obtain additional wafer capacity, procurement of additional capital equipment and facilities, development of new products, and potential acquisitions of technologies or businesses that could complement our business. We may use available cash or other sources of funding for such purposes.

**Factors Affecting Future Results**

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties not presently known to the Company or that the Company's management currently deems immaterial also may impair its business operations. If any of the risks described below were to occur, our business, financial condition, operating results and cash flows would be materially adversely affected.

The semiconductor industry is characterized by rapid technological change, intense competition and cyclical market patterns which contribute to create factors that may affect our future operating results including:

**Market Demand**

- limited visibility of demand for products, especially new products;
- fluctuations in demand for our products and services;
- increased dependence on turns orders (orders received and shipped within the same fiscal quarter);
- reduced capital spending by our customers;
- weaker demand for our products or those of our customers due to a prolonged period of economic uncertainty;
- excess inventory within the supply chain including overbuilding of OEM products;
- additional excess and obsolete inventories and corresponding write-downs due to a significant deterioration in demand;
- inability to manufacture sufficient quantities of a given product in a timely manner;
- inability to obtain manufacturing capacity in sufficient volume;
- inability to predict the success of our customers' products in their markets;
- an unexpected increase in demand resulting in longer lead times that causes delays in customer production schedules;
- dependence on the health of the end markets and customers we serve;

**Competitive Environment**

- price and product competition in the semiconductor industry, which can change rapidly due to technological innovation;
- major customers converting to ASIC designs from Xilinx's PLDs;
- erosion of average selling prices;
- timely introduction of new products;

**Technology**

- lower gross margins due to product mix shifts and reduced manufacturing efficiency improvements;
- failure to retain or attract specialized technical/management personnel;
- timely implementation of new manufacturing technologies;
- ability to safeguard the Company's products from competitors by means of patents and other intellectual property protections;
- impact of new technologies which result in rapid escalation of demand for some products in the face of equally steep declines in demand for others;

**Other**

- changes in accounting rules;
- dependence on distributors to generate sales and process customer orders;
- impact of changes to current export/import laws and regulations;
- volatility of the securities market, particularly as it relates to the high technology sector and our investment in UMC;
- global events impacting the world economy or specific regions of the world; and,
- catastrophes that impact the ability of our supply chain partners to operate or deliver product.

We attempt to identify changes in market conditions as soon as possible; however, the dynamics of the market make prediction of and timely reaction to such events difficult. For example, the overbuilding in the telecommunications industry resulted in a reduction in capital spending causing a slowdown in orders for our products. Due to these and other factors, our past results, including those described in this report, are much less reliable predictors of the future than with companies in many older, more stable and mature industries. Based on the factors noted herein, we may experience substantial fluctuations in future operating results.

Our results of operations are impacted by global economic and political conditions, dependence on new products, dependence on independent manufacturers and subcontractors, competition, intellectual property, and litigation, each of which is discussed in greater detail below.

**Potential Effect of Global Economic and Political Conditions**

Sales and operations outside of the United States subject us to the risks associated with conducting business in foreign economic and regulatory environments. Our financial condition and results of operations could be adversely affected by unfavorable economic conditions in countries in which we do significant business and by changes in foreign currency exchange rates affecting those countries. For example, we have sales and operations in Asia Pacific and Japan. Past economic weakness in these markets adversely affected revenues, and such conditions may occur in the future. Sales to all direct OEMs and distributors are denominated in U.S. dollars. While the recent movement of the Euro and Yen against the U.S. dollar had no material impact to our business, increased volatility could impact our European and Japanese customers. Currency instability may increase credit risks for some of our customers and may impair our customers' ability to repay existing obligations. Increased currency volatility could also positively or negatively impact our foreign currency denominated costs. Any or all of these factors could adversely affect our financial condition and results of operations in the future.

Our financial condition and results of operations are becoming increasingly dependent on the global economy. Any instability in worldwide economic environments, such as experienced after the terrorist attacks on September 11, 2001, could lead to a contraction of capital spending by our customers. Additional risks to us include U.S. military actions, economic sanctions imposed by the U.S. government, government regulation of exports, imposition of tariffs and other potential trade barriers, reduced protection for intellectual property rights in some countries and generally longer receivable collection periods. Moreover, our financial condition and results of operations could be affected in the event of political conflicts in Taiwan where our main wafer provider, UMC, as well as a significant number of suppliers to the semiconductor industry, end customers and contract manufacturers who provide manufacturing services worldwide, are located.

**Dependence on New Products**

Our success depends in large part on our ability to develop and introduce new products that address customer requirements and compete effectively on the basis of price, density, functionality and performance. The success of new product introductions is dependent upon several factors, including:

- timely completion of new product designs;
- ability to generate new design wins;
- ability to engage in key relationships with companies that provide synergistic products and services;
- ability to utilize advanced manufacturing process technologies including a transition to 300 millimeter wafers as well as to circuit geometries on 90 nanometers and smaller;
- achieving acceptable yields;
- ability to obtain adequate production capacity from our wafer foundries and assembly subcontractors;
- ability to obtain advanced packaging;
- availability of supporting software design tools;
- utilization of predefined cores of logic;
- industry acceptance; and,
- successful deployment of systems by our customers.

We cannot assure you that our product development efforts will be successful, that our new products will achieve industry acceptance or that we will achieve the necessary volume of production that would lead to further per unit cost reductions. Revenues relating to our mature products are expected to decline in the future. As a result, we will be increasingly dependent on revenues derived from design wins for our newer products as well as anticipated cost reductions in the manufacture of our current products. We rely primarily on obtaining yield improvements and corresponding cost reductions in the manufacture of existing products and on introducing new products that incorporate advanced features and other price/performance factors that enable us to increase revenues while maintaining consistent margins. To the extent that such cost reductions and new product introductions do not occur in a timely manner, or to the extent that our products do not achieve market acceptance at prices with higher margins, our financial condition and results of operations could be materially adversely affected.

**Dependence on Independent Manufacturers and Subcontractors**

We do not manufacture our own silicon wafers. During fiscal year 2004, all of our wafers were manufactured in Taiwan by UMC, in Japan by Seiko and in the United States by IBM. Terms with respect to the volume and timing of wafer production and the pricing of wafers produced by the semiconductor foundries are determined by periodic negotiations between Xilinx and these wafer foundries, which usually result in short-term agreements. We are dependent on these foundries, especially UMC, which supplies over 70% of our wafers. We rely on UMC to produce wafers with competitive performance and cost attributes, which include transitioning to advanced manufacturing process technologies, producing wafers at acceptable yields, and delivering them in a timely manner. We cannot guarantee that the foundries that supply our wafers will not experience manufacturing problems, including delays in the realization of advanced manufacturing process technologies. In addition, greater demand for wafers produced by the foundries raises the likelihood of potential wafer price increases.

UMC's foundries in Taiwan and Seiko's foundries in Japan as well as many of our operations in California are centered in areas that have been seismically active in the recent past. Should there be a major earthquake in our suppliers' or our operating locations in the future, our operations, including our manufacturing activities, may be disrupted. This type of disruption could result in our inability to ship products in a timely manner, thereby materially adversely affecting our financial condition and results of operations. Additionally, disruption of operations at these foundries for any reason, including other natural disasters such as fires or floods, as well as disruptions in access to adequate supplies of electricity, natural gas or water could cause delays in shipments of our products, and could have a material adverse effect on our results of operations.

We are also dependent on subcontractors to provide semiconductor assembly, test and shipment services. Any prolonged inability to obtain wafers or assembly, test or shipment services with competitive performance cost attributes, adequate yields or timely delivery, or any other circumstance that would require us to seek alternative sources of supply, could delay shipments and have a material adverse effect on our financial condition and results of operations.

**Competition**

Our future success depends on our ability to be competitive in the semiconductor industry. See "Competition" in Item 1. "Business."

**Intellectual Property**

We rely upon patent, copyright, trade secret, mask work and trademark laws to protect our intellectual property. We cannot assure you that such intellectual property rights can be successfully asserted in the future or will not be invalidated, circumvented or challenged. From time to time, third parties, including our competitors, have asserted patent, copyright and other intellectual property rights to technologies that are important to us. We cannot assure you that third parties will not assert infringement claims against us in the future, that assertions by third parties will not result in costly litigation or that we would prevail in such litigation or be able to license any valid and infringed patents from third parties on commercially reasonable terms. Litigation, regardless of its outcome, could result in substantial costs and diversion of our resources. Any infringement claim or other litigation against us or by us could materially adversely affect our financial condition and results of operations.

**Litigation**

We are currently engaged in several legal matters. See Item 3. "Legal Proceedings."