

Good evening, Ladies and Gentlemen

And thank you again for joining us tonight.

INTRODUCTION

Well, one more year has gone. Exactly one year after our New York meeting of May 2001. One year of incredible change: we all know that life will never be the same again, after the events of September 11. At the same time, a year of little deviations from existing trends.

Just an example: there are even more bears and less bulls in this City than we had in the Streets of New York twelve months ago. Lynn, you should remember I had said that the next field trip should be planned in Pamplona, Spain, on the day of Saint Firmin's Fiesta, at the beginning of July, when bulls run freely in the streets. What are we doing here in London, then?

But apart from jokes, life evolves this way: there are major trends that develop their strength and their power with time, sometimes it may require many years for their full deployment. Superimposed on those trends, from time to time, major disruptions take place. Revolutionary changes may happen. No one can really predict them, but we can understand, on the contrary the major trends, analyze them and try to optimize our behavior on them.

THE MAIN TRENDS

Well, tonight, ladies and gentlemen, I will describe three of these main trends, that in my opinion are already impacting microelectronics – and at least in one case impact all business sectors – and will in the medium term play a major role in our future. And let me precise here that for me, in this case, medium term means five to ten years.

The first factor is of technological nature, the second one is of economic nature and the third one is related to social issues.

CONVERGENCE

So let's start from technology, and here the major trend I see is the strengthening of the process of convergence.

I know this phenomenon has been announced and described in detail for more than a decade now. But I have a strong feeling that, after such a long time, not only we lost the memory of what we were exactly waiting for, but we even believe that convergence has

already happened, while the technological conditions for it to happen are just materializing now.

This whole situation reminds me of the Aztecs waiting for centuries the return of one of their most important gods, the Feathered Serpent, sailing back to Mexico from the eastern sea: when the Spaniards arrived on their ships, they were mistakenly taken for that god, and that mistake contributed to changing the history of the New World.

As a matter of fact, something similar is happening with System-on-Chip solutions. In the past, we have been talking so long and so extensively about System-on-Chip technology that today, when very few devices -- if any -- can really claim they integrate a full electronic system, we think of those technological marvels just as if they were things of the past. We have become familiar with the idea of SoC technology since we fully understood the inevitable implications of Moore's law. But still, as I said, only a small minority of chips can today be defined as true SoC devices. Nevertheless, in the mind of many observers of the microelectronics industry, System-on-Chip capabilities are no longer an issue nor they represent a real competitive advantage for semiconductor companies.

Let me say here that I must disagree with such a position.

Not only true SoC devices still represent the minority of today's production, but just a small group of selected companies have the capability of conceiving, designing and producing with adequate volumes and acceptable flexibility those powerful System-on-Chip solutions that are at the heart of today's fast growth applications and markets.

In our experience, delivering SoC solutions to the market requires an uncommon combination of know-how, expertise, relationships and tools that can be found only with a selected number of major players in the industry. The complete recipe for SoC solutions includes no less than eight fundamental elements:

1. System know-how, to be in a position to interact in a productive and synergistic fashion with electronic system producers, even though the final responsibility for the system remains, and will always stay, with the customer
2. Strategic alliances, in order to be able and drive our technology and product designs towards the architectural needs of industry leaders and potential ones
3. A broad IP portfolio, coming from different areas of the business and each of them bringing its specialized contribution, in a synergistic effort towards the best integration solution
4. A wide range of intermixable analog and digital, signal and power basic technologies, as well as volatile and non volatile memory capabilities, that allow to better attack the problem of system integration by making possible for the designer to choose the most suitable technology for each function of the system

5. Powerful engines, with a range of DSP and MCU cores, including dedicated ones, to better address specific market needs
6. The availability of the right design methodology in order to gather, integrate and use the different IP
7. Software expertise, as we are progressively moving upwards in the value chain and application software is now built into silicon
8. And, last but not least, a world class volume manufacturing infrastructure to deliver the new SoC solutions, on time , with the right volume, and at a competitive cost.

Why did I mention these eight points? Well, for two reasons.

The first one, of course, is that these points perfectly describe ST's capabilities as a pioneer and leader in the System-on-Chip approach. And the second one is that they prove my thesis: the availability of System-on-Chip solutions, which we give for granted and tend to archive in the memory of our industry as an achievement of the past, in reality requires such a powerful and synchronous combination of elements that only a selected number of large players can offer. Beyond marketing hype, therefore, true SoCs are still an elite breed of products that are the direct consequence, as all other complex semiconductor devices, of Moore's law. But, since their essence goes beyond pure complexity, they occupy a new step in the evolution ladder.

Evolution, however, never stops.

On one side, System-on-Chip technology will steadily pervade the industry, becoming an indispensable platform for any new development in advanced electronics. On the other hand a new step forward in evolution is being made, and the long awaited convergence of applications into consumer oriented computing/communicating/multimedia appliances, is now beginning to materialize and will rapidly become the most powerful growth engine for the industry. The winning combination for this decade will be in the hands of those companies which will be able to lead in both these new developments.

But again, as in the case of System-on-Chip, the fact that we have been talking about convergence for some 20 year now, makes us think that convergence is a thing of the past, an already achieved target. And, of course, this is not yet true. We are not far away, but the potential of this new development is far from being exploited by the industry.

The original idea of convergence of Computers, Consumer and Communications - was a little naive. At the time, many people understood "convergence" to mean these three separate industry segments would merge into one. It didn't happen.

Through its close relationships with strategic partners in all three industries, ST had quite

a different understanding of convergence: it expected the increasing use of digital techniques to draw these markets closer together and enable any one of them to interact with any of the others in ways that had not previously been possible. But the end result, in market terms, would be difficult to predict. We did not know - because even our customers didn't know at the time - what the market-leading solutions would be. But we knew those solutions would hinge on a set of core competencies and the ability of a few chip manufacturers to integrate any combination of these competencies into a chip that could be designed quickly and manufactured cheaply. This, we thought, was what would break down the barriers between the industry segments. And this is actually happening today, with the birth of equipment that were technically and economically unviable yesterday, including very complex and sophisticated products like the multimedia cellphone.

All of this, in our views, depends on the ability of a small number of chip manufacturers to meet any new scenario their customers propose and respond with a broad enough set of technologies and know-how. And we have prepared for that. We have prepared, in order to be one of the few companies to integrate those complex capabilities and, possibly, to be the world leader among those companies.

At the beginning, our north star was the intuition of differentiated products and System-on-Chip devices as the natural technological evolution of advanced microelectronics. With that in mind, we built for ourselves the eight ingredients for success I mentioned before. But that was not enough. The new paradigm of convergence requires several new steps to be taken.

In order to lead the way in convergence applications, you need to be a leader in five key knowledge areas: Multimedia, Connectivity, Mobility, Security and Storage. Today, convergence means much more than the relaxation of the boundaries between traditional segments of the electronics industry; it means that equipment manufacturers can work with SoC suppliers to build winning systems that are based on any variable combination of those core elements, even when the OEM is not necessarily itself a leader in every one of these areas.

Well, if we now go back to the strategies we had developed and announced when ST was created at the end of the '80s, the long term strategy becomes very clear. We had chosen to focus - aiming at world leadership - in Wireless Communications and Networking, PC peripherals, Digital Consumer, Smart Card chips and in the whole Automotive sector. Now, it is easy to see that there is a perfect match between the focus application areas we have selected and the knowledge areas that are indispensable to master Convergence-on-Chip. Actually, we are convinced that probably no other semiconductor company has achieved the same level of overall leadership in those five areas which, I repeat, are Multimedia, Connectivity, Mobility, Security and Storage.

You will hear more about all this in tomorrow's presentations.

CONSOLIDATION

So, let's now discuss the second main trend, which, for me, is the inevitable consolidation of the industry.

Here, again, we have been expecting our industry to consolidate for many years, and actually many events have happened in that direction. But microelectronics is still a relatively young industry, and we are still reasonably far away from the inflection point in the growth curve. Not only, men – I mean men and women, of course – are very adaptive to the environment. Whenever their way of life or their business is endangered by new situations or trends, they put new countermeasures at work which, even if they cannot change the course of events, they can at least postpone the natural evolution of things.

In my opinion, three fundamental factors are pushing the industry in the direction of consolidation:

- 1) Financial constraints to the exponential growth of capital expenditures to keep manufacturing machines up to date both in terms of new generation processes and wafer diameter evolution.

With the cost of a new front-end plants rapidly evolving into the region of three billion dollars, we all understand what the implications are. And, from what I hear from other companies, very few nightmares are worse than having an empty multibillion dollar facility on your arms and be faced with the need of loading it with products in a tough market situation.

It is true that the industry has found some countermeasures, like sharing plants with competitors or, more frequently operating in the fabless mode. This model, which proves to be very successful for some smaller players, has however some intrinsic weaknesses built-in.

First of all, foundries are not, in general, working for free. They are business enterprises and they need to make profits. If you are a fabless company then you have to take into account an extra margin of some 20-30% on manufacturing to compensate your foundry. And if your competitor is not inefficient in his manufacturing – which is exactly the case for ST – this puts you immediately at a competitive disadvantage. Fabless companies are also too little flexible to serve demand surges for their products when the market is booming (it does indeed, from time to time) and foundries cannot cope with it. And, last but not least, fabless companies up to now have good access to standard CMOS technology only, while access to more sophisticated variations on that theme is – at least today – much less obvious.

- 2) Skyrocketing R&D costs. Paraphrasing Neil Armstrong, going from the 90 nanometers node to the 64 nanometers one is a small step for a company and a giant leap in R&D costs.

And obviously only the big players can really afford keeping up-to-date with their technological platform. But even the bigger players are very conscious about their expenditures. The evolution of species is based upon new adaptive behaviors: the alliances that are being created in this field are exactly that. Sharing R&D reduces not only costs, but also risks.

And, once again, in order to validly participate in a shared R&D effort you have to have grown beyond a certain threshold...

- 3) The complexity of System-on-Chip devices, which, as I said, represent today a small minority of actual IC designs, but which will become exponentially more popular and evolve very soon to Convergence-on-Chip systems, requires the mastering of such a wide and complex range of IP blocks that small players will simply not be in a position to afford it.

It is true that IP can be acquired. But while commodity IP blocks are available at very reasonable prices, “strategic” IP’s are the best protected assets of any corporation. Basically, money cannot buy them, and those who need them and don’t have them can succeed only if they can rely upon a rich IP portfolio for trading.

Does this mean that small companies are not viable per se? Do I think they cannot successfully exploit their niche? The answer of course is no. Niche companies, thanks to their flexibility, speed and, most of all, creativity can be very successful. But with an obvious limitation. They must innovate and leap forward to a new niche before a big fish jumps into their pond, which is usually rich in food, but not for both of them.

And this is why, ladies and gentlemen, I am glad we are one of the largest fishes in the world.

SOCIAL ROLE OF CORPORATIONS

And let me underline that I said “large fish” and not “shark”.

This brings me to the third major trend I would like to discuss tonight.

For the past several years, I have been openly supporting the concept that there is no intrinsic contradiction between shareholders value and stakeholders value. On the contrary, I do believe that those corporations that pay special attention to their social role and to their behavior as good corporate citizens in the environment where they operate

not only fulfill their ethical obligations, but also maximize the return to their shareholders.

I think that ST, with its unwavering commitment to sustainable development, is a good proof of that. We have started our endless journey towards environmental neutrality seven years ago with our initial intuition that the adoption of processes that were less hungry in terms of energy and raw materials would automatically have brought savings that would have made our company intrinsically more competitive. Facts have proven that that reasoning was absolutely correct.

I will not repeat here the details of a story that is probably well known. We have adopted an environmental decalogue, which provides the timeline and the quantitative milestones for Reducing, Reusing, Recycling as much as we can reasonably could. And, by religiously following that decalogue, we became probably the best in the industry for environmental protection, and we created more profits too. On average the pay-back on our environmental protection investments is two and a half years. And just in the year 2000 we saved \$50 million just in our electricity and water bills. While at the same time saving the world from another 100 MWatt power station and enough water for a population of 50 million people to drink in one year.

But, as I said this is just one aspect of our social attitude.

We recognize the importance of addressing the three interlinked goals of economic prosperity, environmental protection and social equity as we work to balance the positive aspects of wealth creation and economic growth needed to create a better quality of life for present and future generations.

We bring those values to the global workplace. We bring technology, we bring education, most of all we bring one of the most deeply interiorized Total Quality Management programs of the industry and the empowerment of our employees – within their organizations -- to act and constantly improve processes. We have some 40.000 people in 27 countries...our philosophy is to educate and train them, help develop their skills and confidence, encourage their innovative and creative minds, recognize their achievements, make them the center of the enterprise – actors and not just factors of the business process – make them and their families feel good. This is our internal social responsibility.

However, a better quality of life for our employees only is simply not enough. As a leading technology company, we feel a strong obligation to help cultivate technological development worldwide, not just in the most economically advantaged nations and communities. This is why we are actively participating in the United Nations' ICT Task force that has been created by assembling UN organizations, representatives of governments from all continents, non governmental organizations, and private enterprises, with the goal of helping bridging the Digital Divide. The difference between those who have and those who have not high quality access to information and know-how is becoming even more important for achieving personal success than that between those

who have or have not material resources at their disposal. If we do nothing about it, today's elites will emerge and reach even higher peaks of wealth and power, while the widening of the digital divide will inevitably create new areas of poverty.

In my opinion, we must avoid letting people fall through the Net. Therefore, we are working to create a widespread movement and mobilize voluntary donations not only of hardware, software and communications connections but of financial and human resources.

Why get business involved? First of all, let me repeat it once again, because I am deeply convinced that socially responsible companies – that is, companies which are committed to promoting the well-being of the communities in which they work – generate more value not only for all stakeholders but also for their shareholders.

Secondly, in the long run, the more advanced economies will clearly benefit if, by triggering a process to limit the digital divide and to contribute to the development of poorer parts of the world, new markets and new opportunities for trade and production are created. It would undoubtedly be beneficial for all corporations to have three billion potential new consumers instead of three billion people living in poverty. In addition, there are the benefits in terms of safety and peace for the whole world – for our families and the communities we live in – if there is less conflict in the future.

But there is another, even more pressing reason why corporations should be engaged in social programs like fighting the digital divide or protecting our planet's environment. I believe that these initiatives provide that extra motivation in employees that makes the real difference in the performance of corporations. In a world of global business, where access to financial resources and to equipment and material is no longer a discriminating factor, people, the quality of people and their commitment to corporate values represent the most important competitive factor for most business enterprises. I strongly believe that our responsible corporate citizenship programs are helping ST employees to identify with a company which is capable not only of achieving outstanding economic results but also of reflecting their deepest aspirations.

Which are also ours.

Thank you for your attention.