Accelerate Business Restructuring and Build a Corporate Structure for Long-Term Growth

Yukihiro Ukai
President and Representative Director

Q What were the results for the fiscal year ended March 31, 2010?

A **Despite declines in both sales and profits reflecting weak demand for existing products, we moved forward with the restructuring of our organizations to establish a recession-proof business structure.**

During the fiscal year ended March 31, 2010, the market conditions surrounding the electronic industry in which we operate remained stagnant, with the market contracting on a year-on-year basis. Under the circumstances, we actively promoted two main businesses: the LSI business, which focuses on markets for games, amusements, digital cameras and high-definition audio visual (AV) devices, and the systems business, which is engaged in the security market.

As a result, net sales for the fiscal year under review amounted to ¥38,495 million on a consolidated basis (down 27.1% from the previous fiscal year ended March 31, 2009). Operating income stood at ¥3,034 million (down 36.9%), and net income was ¥2,140 million (down 19.9%). The more modest decline in net income in comparison to operating income was attributable to a fall in the extraordinary loss, and the reversal of income taxes, as a result of the revision to the applicable scope of the tax exemption to research and development expenses.

Looking at results by business segment, in the LSI business, net sales were ¥36,124 million (down 25.6% from the year ended March 31, 2009), and operating income stood at ¥4,212 million (a fall of 12.1%). These declines were mainly attributable to weak demand for LSIs for storing game software (custom memories), our main product, and for tuner modules for receiving 1 seg digital terrestrial broadcasting, as well as a delay in shipment of new LSI products for amusements areas. Meanwhile, demand for LSIs for digital camera image processing and LSIs for high-definition AV recording remained strong.

In the systems business, net sales were ¥2,371 million (down 43.6% year on year) and the operating loss was ¥1,141 million (compared with an operating income of ¥22 million for the previous year ended March 31, 2009). These stagnant results were due to sluggish capital spending reflecting the ongoing economic slowdown and reduced demand for customer-specific full digital image monitoring systems.

Although both business segments posted lower sales and profits, as described above, we have made steady progress with initiatives to develop a resilient corporate structure by developing products for new business areas, carrying out restructuring that includes a review of existing business models, streamlining operations, and cutting costs. In this sense, we believe that the fiscal year ended March 31, 2010 was a year that we took positive steps for our future development.

Q What is the status and outlook of business restructuring?

A We will continue to reform our business portfolio by focusing on the customer-oriented business, and review our business management in a comprehensive manner.

The Japanese economy has finally begun to move out of the worst economic slowdown of its postwar history, which was part of a global economic sluggishness, with certain sectors beginning to show signs of a recovery. Nonetheless, an economic downturn such as the one we have just been through could happen in the future. To withstand these changes in the business environment, and achieve sustainable growth in the future, we have established a medium-term management plan (refer to Page 5), which began in the fiscal year ending March 31, 2011. Under this plan, we will execute management reforms through three restructuring initiatives.

The first initiative is to concentrate on the customer-oriented business of our existing project. In the game business, we will increase our product lineups by proposing a wide range of solutions, such as modules for receiving 1 seg digital terrestrial broadcasting, in addition to our main products, LSIs for storing game software. Through this initiative, we will strive to enhance relationships with our customers, and to strengthen and diversify our business. In the digital home appliance business, harnessing our image processing IP (design assets), such as JPEG XR (standardized internationally in June 2009), the still image compression format for the next generation that we have developed, we have been operating specific LSIs, modules and the IP business (the provision of design assets) targeting major customers, while moving ahead with planning and development projects with new customers.

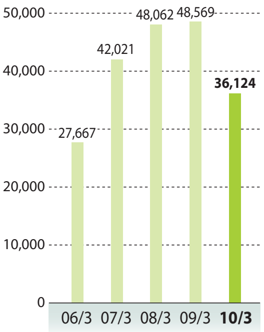
In the security business, meanwhile, we will streamline development and production by concentrating on developing systems tailored to customer applications. We will also strive to improve profitability by reviewing the cost structure of our products, including cost prices.

Our second restructuring initiative is to develop new businesses and ensure appropriate business portfolio. In the amusement (Pachinko) business, one of the new businesses that are expected to grow, we will approach new customers by proposing sophisticated but inexpensive memory products. Unfortunately, we could not begin mass production and sales of these products in the fiscal year ended March 31, 2010, but they are expected to contribute to results for the fiscal year ending March 31, 2011.

LSI Business

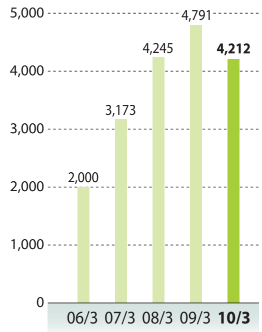
Net Sales

(¥ Millions)



Operating Income

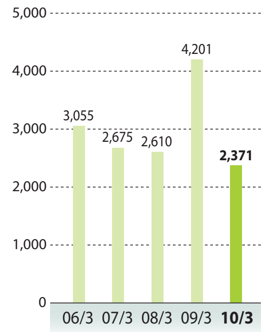
(¥ Millions)



Systems Business

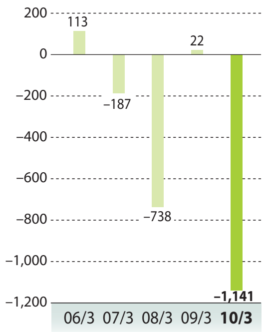
Net Sales

(¥ Millions)



Operating Income

(¥ Millions)



We have also targeted the fields of home infrastructure, energy and ecology as new business areas that are expected to grow in the future given rising social demands for global environmental protection. As planning and development of products in these businesses are still underway, we are not able to disclose details just yet. Still, we have already commenced joint research and technological development with customers, and we are determined to strengthen and drive these businesses forward as an engine of growth over the medium and long terms.

The third restructuring initiative is to execute reforms for higher revenue. In the severe management environment we face now, it is a critical challenge to transform our corporate structure into one that can secure high profitability with limited capital investment. Through a number of approaches, including the active use of alliances, cost control from the development stage, shortening of the production period, inventory reduction, and operational efficiency improvements, we will aim to thoroughly eliminate waste and improve operating efficiency.

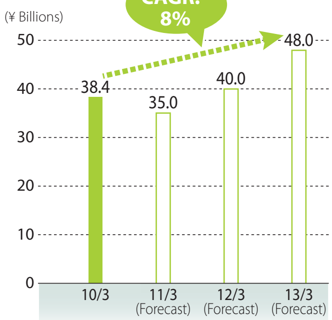
Medium-Term Management Plan
(from the fiscal year ending March 31, 2011 to the fiscal year ending March 31, 2013)

Basic Policy

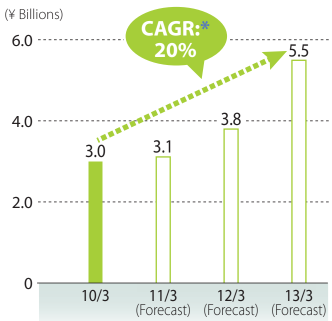
1. Focus on customer-oriented business and work with customers to nurture the business to ensure long-term growth and development.
2. Emphasize management stability and construct an effective business portfolio.
3. Enhance operating efficiency by executing reforms for higher revenue.

Numerical Targets

Net Sales

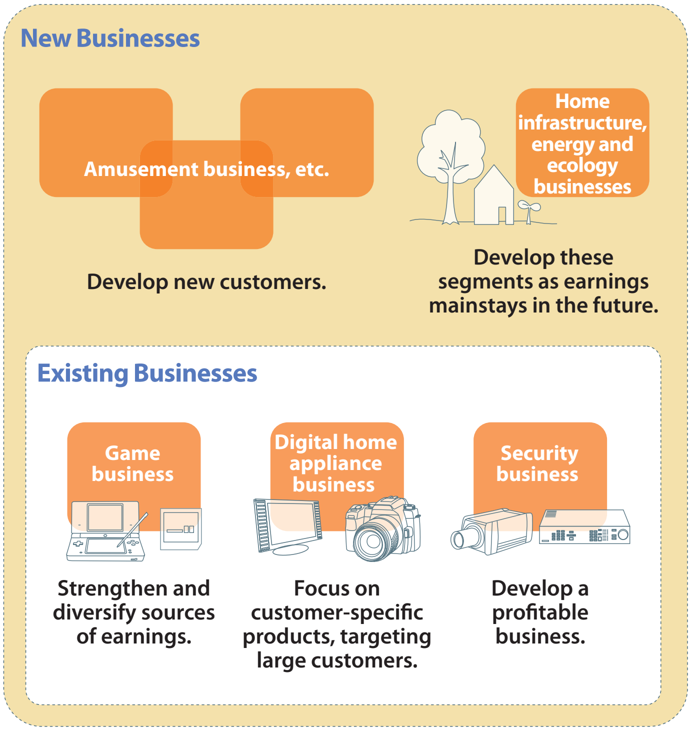


Operating Income



* CAGR: Compound Annual Growth Rate

Business Portfolio to be Achieved through the Medium-Term Growth Strategy



Q How is the profit allocation?

A We have paid ¥27 per share for the fiscal year ended March 31, 2010 in accordance with our dividend policy.

We regard the appropriate profit allocation to shareholders as an important management issue. The amount of dividends is determined by payout ratio of about 30% or about 2% of the consolidated dividends on equity (DOE), whichever is greater, with consideration given to factors such as consolidated financial results, financial conditions, and investment plans.

In accordance with the above policy, we paid an annual dividend of ¥27 per share as an ordinary dividend to shareholders as of March 31, 2010. Meanwhile, we did not acquire treasury stock in the fiscal year ended March 31, 2010, but we canceled 313,417 shares of our treasury stock on November 30, 2009.

We aim to improve the value of our shares and capital efficiency, taking a comprehensive view of the market and business environment, and will strive to meet the expectations of our shareholders.

Q What is the financial outlook for the fiscal year ending March 31, 2011?

A We seek to maintain profits despite an anticipated fall in sales, by steadily advancing the development of a resilient corporate structure through an efficiency drive and cost savings.

The electronic industry in general is likely to continue to face an uncertain business outlook in the fiscal year ending March 31, 2011. Given this business environment, we expect that net sales will be about ¥35 billion (down 9.1% year-on-year) on a consolidated basis. As previously mentioned, we have made steady progress on the development of a resilient corporate structure through our efficiency drive and cost savings, and we expect ¥3.1 billion in operating income (a rise of 2.1% from a year earlier) and ¥2.15 billion in net income (rise of 0.4%), the same level as the previous period. We regard the current fiscal year as a critical period for us to achieve medium- to long-term growth. We will carry out aggressive business activities, including investment in research and development for new

2009 Sales Ranking of Fabless IC Suppliers

Rank	Headquarters	Company
1	U.S.	Qualcomm
2	U.S.	AMD
3	U.S.	Broadcom
4	Taiwan	MediaTek
5	U.S.	Nvidia
6	U.S.	Marvell Technology Group
7	U.S.	Xilinx
8	U.S.	LSI Corp.
9	U.S.	Altera
10	U.S.	Avago Technologies
11	Taiwan	Novatek
12	Taiwan	Himax Technologies
13	Taiwan	Realtek Semiconductor
14	Taiwan	Mstar Semiconductor
15	Europe	CSR
16	U.S.	Qlogic
17	U.S.	Atheros Communications
18	U.S.	PMC-Sierra
19	**Japan**	**MegaChips**
20	U.S.	Silicon Laboratories

Source: IC Insights, Inc. announced in January 2010

businesses, and the marketing to a larger customer base. Through these initiatives, we will aim to achieve net sales of ¥48 billion and an operating income of ¥5.5 billion for the fiscal year ending March 31, 2013.

On April 4, 2010, we marked our 20th anniversary. Taking this opportunity, we added the concept of "global environment" to our corporate mission and adopted a new vision: Help people achieve safety, security, and fulfilling lives, while protecting the global environment, based on sophisticated technological capabilities. This is the key challenge for us to flexibly respond to the ever changing needs of society and the market, including global environmental issues, and to actively contribute to the world through our unique technologies. We believe that our ability to address these challenges will determine the future of MegaChips.

We regard this year as our "second start-up" and will build a competitive advantage in the world market, refusing to remain just the leading fabless LSI manufacturer in Japan, through a comprehensive business review by each employee and the establishment of an optimal business model from a medium-to long-term standpoint.

We greatly appreciate your continued support and cooperation.

July 2010

Yukihiro Ukai

President and Representative Director