

CONEXANT SYSTEMS INC

Form 10-Q

August 06, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the Quarterly Period Ended June 29, 2007**

**OR**

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

**Commission file number: 000-24923**

**CONEXANT SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of incorporation)

**25-1799439**

(I.R.S. Employer Identification No.)

**4000 MacArthur Boulevard**

**Newport Beach, California 92660-3095**

(Address of principal executive offices) (Zip code)

**(949) 483-4600**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of July 27, 2007, there were 490,634,753 shares of the registrant's common stock outstanding.

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**FORWARD-LOOKING STATEMENTS**

In addition to historical information, this Quarterly Report on Form 10-Q contains statements relating to future results of Conexant Systems, Inc. (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. Our actual results may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to:

pricing pressures and other competitive factors;

the timing of our new product introductions and product quality;

the cyclical nature of the semiconductor industry and the markets addressed by our products and our customers products;

the risk that the value of our common stock may be adversely affected by market volatility;

the substantial losses we have incurred recently;

general economic and political conditions and conditions in the markets we address;

continuing volatility in the technology sector and the semiconductor industry;

demand for and market acceptance of new and existing products;

successful development of new products;

our ability to anticipate trends and develop products for which there will be market demand;

the risk that capital needed for our business and to repay our indebtedness will not be available when needed;

the availability of manufacturing capacity;

changes in product mix;

product obsolescence;

the ability of our customers to manage inventory;

our ability to develop and implement new technologies and to obtain protection for the related intellectual property;

the uncertainties of litigation, including claims of infringement of third-party intellectual property rights or demands that we license third-party technology, and the demands it may place on the time and attention of our management and the expense it may place on our company; and

possible disruptions in commerce related to terrorist activity or armed conflict, as well as other risks and uncertainties, including those set forth herein and those detailed from time to time in our other Securities and Exchange Commission filings. These forward-looking statements are made only as of the date hereof, and we undertake no obligation to update or revise the forward-looking statements, whether as a result of new

information, future events or otherwise, except as otherwise required by law.

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONEXANT SYSTEMS, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets  
(unaudited, in thousands, except par value)**

|                                                                                                                                            | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|-----------------------------------|
| <b>ASSETS</b>                                                                                                                              |                          |                                   |
| <b>Current assets:</b>                                                                                                                     |                          |                                   |
| Cash and cash equivalents                                                                                                                  | \$ 158,162               | \$ 225,626                        |
| Marketable securities                                                                                                                      | 65,969                   | 115,709                           |
| Restricted cash                                                                                                                            | 8,800                    | 8,800                             |
| Receivables, net of allowances of \$1,732 and \$842                                                                                        | 95,121                   | 123,025                           |
| Inventories, net                                                                                                                           | 63,318                   | 97,460                            |
| Other current assets                                                                                                                       | 22,194                   | 19,353                            |
| Total current assets                                                                                                                       | 413,564                  | 589,973                           |
| Property, plant and equipment, net                                                                                                         | 70,084                   | 65,405                            |
| Goodwill                                                                                                                                   | 580,694                  | 710,790                           |
| Intangible assets, net                                                                                                                     | 41,123                   | 76,008                            |
| Other assets                                                                                                                               | 92,594                   | 131,449                           |
| Total assets                                                                                                                               | \$ 1,198,059             | \$ 1,573,625                      |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                                                                                                 |                          |                                   |
| <b>Current liabilities:</b>                                                                                                                |                          |                                   |
| Current portion of long-term debt                                                                                                          | \$ 43,900                | \$ 188,375                        |
| Short-term debt                                                                                                                            | 80,000                   | 80,000                            |
| Accounts payable                                                                                                                           | 68,650                   | 113,690                           |
| Accrued compensation and benefits                                                                                                          | 28,672                   | 28,307                            |
| Other current liabilities                                                                                                                  | 44,023                   | 51,966                            |
| Total current liabilities                                                                                                                  | 265,245                  | 462,338                           |
| Long-term debt                                                                                                                             | 481,100                  | 518,125                           |
| Other liabilities                                                                                                                          | 66,668                   | 83,064                            |
| Total liabilities                                                                                                                          | 813,013                  | 1,063,527                         |
| Commitments and contingencies (Note 4)                                                                                                     |                          |                                   |
| <b>Shareholders equity:</b>                                                                                                                |                          |                                   |
| Preferred and junior preferred stock                                                                                                       |                          |                                   |
| Common stock, \$0.01 par value: 1,000,000 shares authorized; 490,631 and 486,482 shares issued; and 490,631 and 485,200 shares outstanding | 4,906                    | 4,866                             |

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|                                                |              |              |
|------------------------------------------------|--------------|--------------|
| Treasury stock: zero and 1,282 shares, at cost |              | (5,823)      |
| Additional paid-in capital                     | 4,715,410    | 4,699,029    |
| Accumulated deficit                            | (4,343,454)  | (4,175,757)  |
| Accumulated other comprehensive income (loss)  | 8,282        | (12,096)     |
| Shareholder notes receivable                   | (98)         | (121)        |
| Total shareholders' equity                     | 385,046      | 510,098      |
| Total liabilities and shareholders' equity     | \$ 1,198,059 | \$ 1,573,625 |

See accompanying notes to condensed consolidated financial statements.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**  
**(unaudited, in thousands, except per share amounts)**

|                                                                       | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|-----------------------------------------------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                                                       | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| Net revenues                                                          | \$ 179,549                | \$ 251,635               | \$ 624,948               | \$ 724,924               |
| Cost of goods sold <sup>(1)</sup>                                     | 101,503                   | 137,598                  | 347,564                  | 408,924                  |
| Gain on cancellation of supply agreement                              |                           | (17,500)                 |                          | (17,500)                 |
| Gross margin                                                          | 78,046                    | 131,537                  | 277,384                  | 333,500                  |
| Operating expenses:                                                   |                           |                          |                          |                          |
| Research and development <sup>(1)</sup>                               | 68,890                    | 70,096                   | 209,685                  | 199,286                  |
| Selling, general and administrative <sup>(1)</sup>                    | 26,234                    | 27,037                   | 80,513                   | 101,958                  |
| Amortization of intangible assets                                     | 4,823                     | 7,520                    | 17,315                   | 23,185                   |
| Special charges                                                       | 5,071                     | 32,610                   | 168,090                  | 72,379                   |
| Total operating expenses                                              | 105,018                   | 137,263                  | 475,603                  | 396,808                  |
| Operating loss                                                        | (26,972)                  | (5,726)                  | (198,219)                | (63,308)                 |
| Interest expense                                                      | (11,349)                  | (10,426)                 | (37,605)                 | (29,280)                 |
| Other income (expense), net                                           | 3,656                     | (49,259)                 | 26,377                   | (3,120)                  |
| Loss before income taxes and gain (loss) on equity method investments | (34,665)                  | (65,411)                 | (209,447)                | (95,708)                 |
| Provision for income taxes                                            | 741                       | 1,031                    | 2,444                    | 2,482                    |
| Loss before gain (loss) on equity method investments                  | (35,406)                  | (66,442)                 | (211,891)                | (98,190)                 |
| Gain (loss) on equity method investments                              | 179                       | (648)                    | 44,194                   | (3,303)                  |
| Net loss                                                              | \$ (35,227)               | \$ (67,090)              | \$ (167,697)             | \$ (101,493)             |
| Net loss per share basic and diluted                                  | \$ (0.07)                 | \$ (0.14)                | \$ (0.34)                | \$ (0.21)                |
| Shares used in basic and diluted per-share computations               | 490,558                   | 481,626                  | 488,613                  | 477,716                  |

<sup>(1)</sup> These captions include non-cash

employee  
stock-based  
compensation  
expense as  
follows (see  
Note 1):

|                                     | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                 |
|-------------------------------------|---------------------------|-----------------|--------------------------|-----------------|
|                                     | <b>June 29,</b>           | <b>June 30,</b> | <b>June 29,</b>          | <b>June 30,</b> |
|                                     | <b>2007</b>               | <b>2006</b>     | <b>2007</b>              | <b>2006</b>     |
| Cost of goods sold                  | \$ 143                    | \$ 31           | \$ 361                   | \$ 460          |
| Research and development            | 3,104                     | 6,643           | 8,186                    | 17,791          |
| Selling, general and administrative | 1,891                     | 3,502           | 5,699                    | 18,993          |

See accompanying notes to condensed consolidated financial statements.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows**  
**(unaudited, in thousands)**

|                                                                                                             | <b>Nine Months Ended</b> |                 |
|-------------------------------------------------------------------------------------------------------------|--------------------------|-----------------|
|                                                                                                             | <b>June 29,</b>          | <b>June 30,</b> |
|                                                                                                             | <b>2007</b>              | <b>2006</b>     |
| <b>Cash flows from operating activities:</b>                                                                |                          |                 |
| Net loss                                                                                                    | \$ (167,697)             | \$ (101,493)    |
| Adjustments to reconcile net loss to net cash used in operating activities, net of effects of acquisitions: |                          |                 |
| Depreciation                                                                                                | 18,441                   | 14,167          |
| Amortization of intangible assets                                                                           | 17,315                   | 23,185          |
| Asset impairments                                                                                           | 158,415                  |                 |
| Reversal of provision for bad debts, net                                                                    | (219)                    | (2,243)         |
| (Reversal of) charges for inventory provisions, net                                                         | (4,203)                  | 1,594           |
| Stock-based compensation                                                                                    | 14,246                   | 37,244          |
| (Increase) decrease in fair value of derivative instruments                                                 | (7,868)                  | 3,800           |
| (Gains) losses on equity method investments                                                                 | (44,194)                 | 3,303           |
| Gains on sales of equity securities and other assets                                                        | (6,291)                  | (4,414)         |
| Gain on cancellation of supply agreement                                                                    |                          | (17,500)        |
| Impairment loss on Skyworks investment                                                                      |                          | 18,456          |
| Other items, net                                                                                            | (858)                    | (898)           |
| Changes in assets and liabilities:                                                                          |                          |                 |
| Receivables                                                                                                 | 28,123                   | (55,929)        |
| Inventories                                                                                                 | 39,584                   | 10,063          |
| Accounts payable                                                                                            | (44,346)                 | 22,610          |
| Accrued expenses and other current liabilities                                                              | (11,129)                 | (3,295)         |
| Other, net                                                                                                  | (7,267)                  | (2,913)         |
| Net cash used in operating activities                                                                       | (17,948)                 | (54,263)        |
| <b>Cash flows from investing activities:</b>                                                                |                          |                 |
| Proceeds from sales of equity securities and other assets                                                   | 105,923                  | 5,200           |
| Proceeds from sales and maturities of marketable securities                                                 | 84,819                   | 89,862          |
| Purchases of marketable securities                                                                          | (26,462)                 | (62,796)        |
| Purchases of property, plant and equipment                                                                  | (23,133)                 | (23,500)        |
| Payments for acquisitions, net of cash acquired                                                             | (5,029)                  | (6,900)         |
| Purchases of equity securities                                                                              | (600)                    | (705)           |
| Restricted cash                                                                                             |                          | (8,800)         |
| Net cash provided by (used in) investing activities                                                         | 135,518                  | (7,639)         |
| <b>Cash flows from financing activities:</b>                                                                |                          |                 |
| Proceeds from short-term debt, net of expenses of \$1,198 and \$1,541                                       | (1,198)                  | 78,459          |
| Proceeds from long-term debt, net of expenses of \$9,988 and \$6,391                                        | 265,012                  | 243,609         |
| Repurchases and retirements of long-term debt                                                               | (456,500)                | (254,684)       |

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|                                                      |            |            |
|------------------------------------------------------|------------|------------|
| Proceeds from issuance of common stock               | 7,627      | 17,112     |
| Repayment of shareholder notes receivable            | 25         | 163        |
| Net cash (used in) provided by financing activities  | (185,034)  | 84,659     |
| Net (decrease) increase in cash and cash equivalents | (67,464)   | 22,757     |
| Cash and cash equivalents at beginning of period     | 225,626    | 202,704    |
| Cash and cash equivalents at end of period           | \$ 158,162 | \$ 225,461 |

See accompanying notes to condensed consolidated financial statements.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**1. Basis of Presentation and Significant Accounting Policies**

Conexant Systems, Inc. (Conexant or the Company) designs, develops and sells semiconductor system solutions, comprised of semiconductor devices, software and reference designs, for use in broadband communications applications that enable high-speed transmission, processing and distribution of audio, video, voice and data to, and throughout, homes and business enterprises worldwide. The Company's access solutions connect people through personal communications access products, such as personal computers (PCs) and television set-top boxes (STBs), to audio, video, voice and data services over wireless and wire line broadband connections, as well as over dial-up Internet connections. The Company's central office solutions are used by service providers to deliver high-speed audio, video, voice and data services over copper telephone lines and fiber optic networks to homes and businesses around the world. In addition, the Company's media processing products enable the capture, display, storage, playback and transfer of audio and video content in applications throughout home and small office environments. These solutions enable broadband connections and network content to be shared throughout a home or small office-home office environment using a variety of communications devices, which the Company describes as the broadband digital home.

***Interim Reporting*** The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of adjustments of a normal recurring nature, as well as special charges, necessary to present fairly the Company's financial position, results of operations and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 29, 2006.

***Fiscal Periods*** The Company's fiscal year is the 52- or 53-week period ending on the Friday closest to September 30. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal 2006 was a 52-week year, and fiscal 2007 will also consist of 52 weeks.

***Supplemental Cash Flow Information*** Cash paid for interest was \$30.5 million and \$22.4 million for the nine months ended June 29, 2007 and June 30, 2006, respectively. Cash paid for income taxes for the nine months ended June 29, 2007 and June 30, 2006 was \$1.8 million and \$1.3 million, respectively.

***Revenue Recognition*** The Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the sales price and terms are fixed and determinable, and (iv) the collection of the receivable is reasonably assured. These terms are typically met upon shipment of product to the customer, except for certain distributors who have unlimited contractual rights of return or for whom the contractual terms were not enforced, or when significant vendor obligations exist. Revenue with respect to sales to distributors with unlimited rights of return or for whom contractual terms were not enforced is deferred until the products are sold by the distributors to third parties. At June 29, 2007 and September 29, 2006, deferred revenue related to sales to these distributors was \$6.9 million and \$6.7 million, respectively. Revenue with respect to sales to customers to whom the Company has significant obligations after delivery is deferred until all significant obligations have been completed. At June 29, 2007 and September 29, 2006, deferred revenue related to shipments of products for which the Company has on-going performance obligations was \$3.0 million and \$6.6 million, respectively. The majority of the Company's distributors have limited stock rotation rights, which allow them to rotate up to 10% of product in their inventory two times a year. The Company recognizes revenue to these distributors upon shipment of product to the distributor, as the stock rotation rights are limited and the Company believes that it has the ability to reasonably estimate and establish allowances for expected product returns in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When Right of Return Exists. Development revenue is recognized when services are

performed and was not significant for any periods presented.

Deferred revenue is included in other current liabilities on the accompanying condensed consolidated balance sheets.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**Shipping and Handling** In accordance with Emerging Issues Task Force (EITF) Issue No. 00-10, Accounting for Shipping and Handling Fees and Costs, the Company includes shipping and handling fees billed to customers in net revenues. Amounts incurred by the Company for freight are included in cost of goods sold.

**Cash and Cash Equivalents** The Company considers all highly liquid investments with insignificant interest rate risk and original maturities of three months or less from the date of purchase to be cash equivalents. The carrying amounts of cash and cash equivalents approximate their fair values.

**Marketable Securities** The Company's marketable securities are classified as available-for-sale and are reported at fair value on the accompanying condensed consolidated balance sheets. Unrealized gains and losses are reported in accumulated other comprehensive income (loss), a component of shareholders' equity, on the Company's condensed consolidated balance sheets. Realized gains and losses and declines in value deemed to be other-than-temporary are included in other income, net in the accompanying condensed consolidated statements of operations. In determining whether a decline in value is other-than-temporary, the Company evaluates, among other factors, (i) the duration and extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. The Company does not hold any securities for speculative or trading purposes. The Company considers its available-for-sale portfolio as available for use in its current operations. Accordingly, the Company classifies all marketable securities as short-term, even though the stated maturity dates may be more than one year beyond the current balance sheet date.

**Restricted Cash** Restricted cash represents amounts used to collateralize a consolidated subsidiary's obligations under an \$80.0 million credit facility with a bank. See Note 3 for further information regarding the credit facility.

**Stock-Based Compensation** The Company adopted SFAS No. 123(R), Share-Based Payment on October 1, 2005. Under SFAS No. 123(R), the Company is required to measure compensation cost for all stock-based awards at fair value on the date of grant and recognize compensation expense in its consolidated statements of operations over the service period that the awards are expected to vest. As permitted under SFAS No. 123(R), the Company elected to recognize compensation cost for all options with graded vesting granted on or after October 1, 2005 on a straight-line basis over the vesting period of the entire option. For options with graded vesting granted prior to October 1, 2005, the Company will continue to recognize compensation cost over the vesting period following the accelerated recognition method described in Financial Accounting Standards Board (FASB) Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, as if each underlying vesting date represented a separate option grant.

Under SFAS No. 123(R), the Company records in its consolidated statements of operations (i) compensation cost for options granted, modified, repurchased or cancelled on or after October 1, 2005 under the provisions of SFAS No. 123(R) and (ii) compensation cost for the unvested portion of options granted prior to October 1, 2005 over their remaining vesting periods using the amounts previously measured under SFAS No. 123 for pro forma disclosure purposes.

Consistent with the valuation method for the disclosure-only provisions of SFAS No. 123(R), the Company uses the Black-Scholes-Merton model to value the compensation expense associated with stock-based awards. In addition, forfeitures are estimated when recognizing compensation expense, and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

The following weighted average assumptions were used in the estimated grant date fair value calculations for stock options and stock purchase plan awards:

|                                  | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|----------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                  | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| Stock option plans:              |                           |                          |                          |                          |
| Expected dividend yield          | 0%                        | 0%                       | 0%                       | 0%                       |
| Expected stock price volatility  | 68%                       | 74%                      | 68%                      | 76%                      |
| Risk-free interest rate          | 4.6%                      | 4.9%                     | 4.6%                     | 4.5%                     |
| Average expected life (in years) | 5.25                      | 5.25                     | 5.25                     | 5.25                     |
| Stock purchase plan:             |                           |                          |                          |                          |
| Expected dividend yield          | 0%                        | 0%                       | 0%                       | 0%                       |
| Expected stock price volatility  | 53%                       | 76%                      | 60%                      | 76%                      |
| Risk-free interest rate          | 4.7%                      | 4.4%                     | 4.8%                     | 4.4%                     |
| Average expected life (in years) | 0.50                      | 0.50                     | 0.50                     | 0.50                     |

The expected stock price volatility rates are based on the historical volatility of the Company's common stock. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option or award. The average expected life represents the weighted average period of time that options or awards granted are expected to be outstanding, as calculated using the simplified method described in the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 107.

**Derivative Financial Instruments** The Company's derivative financial instruments as of June 29, 2007 principally consist of (i) the Company's warrant to purchase 30 million shares of Mindspeed Technologies, Inc. (Mindspeed) common stock and (ii) foreign currency forward exchange contracts. See Note 3 for further information regarding the Mindspeed warrant.

The Company's foreign currency forward exchange contracts are used to hedge certain Indian Rupee-denominated and Chinese Yuan-denominated forecasted transactions related to its research and development efforts in India and China. The foreign currency forward contracts used to hedge these exposures are reflected at their fair values on the accompanying condensed balance sheets and meet the criteria for designation as foreign currency cash flow hedges. The criteria for designating a derivative as a hedge include that the hedging instrument should be highly effective in offsetting changes in the designated hedged item. The Company has determined that its non-deliverable foreign currency forward contracts to purchase Indian Rupees and Chinese Yuan are highly effective in offsetting the variability in the U.S. Dollar forecasted cash transactions resulting from changes in the U.S. Dollar to Indian Rupee and U.S. Dollar to Chinese Yuan spot foreign exchange rates. For these derivatives, the gain or loss from the effective portion of the hedge is reported as a component of accumulated other comprehensive income (loss) on the Company's balance sheets and is recognized in the Company's statements of operations in the periods in which the hedged transaction affects operations, and within the same statement of operations line item as the impact of the hedged transaction. The gain or loss is recognized immediately in other (income) expense, net in the statements of operations when a designated hedging instrument is either terminated early or an improbable or ineffective portion of the hedge is identified.

At June 29, 2007, the Company had outstanding foreign currency forward exchange contracts with a notional amount of 885 million Indian Rupees, approximately \$20.6 million, maturing at various dates through January 2008 and a notional amount of 8.5 million Chinese Yuan, approximately \$1.1 million, maturing at various dates through July 2007. Based on the fair values of these contracts, the Company recorded a derivative asset of \$1.1 million at June 29, 2007. During the three and nine months ended June 29, 2007 and June 30, 2006, there were no significant

gains or losses recognized in the statements of operations for hedge ineffectiveness.

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The Company may use other derivatives from time to time to manage its exposure to changes in interest rates, equity prices or other risks. The Company does not enter into derivative financial instruments for speculative or trading purposes.

**Net Loss Per Share** Net loss per share is computed in accordance with SFAS No. 128, Earnings Per Share. Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding and potentially dilutive securities outstanding during the period. Potentially dilutive securities include stock options and warrants and shares of stock issuable upon conversion of the Company's convertible subordinated notes. The dilutive effect of stock options and warrants is computed under the treasury stock method, and the dilutive effect of convertible subordinated notes is computed using the if-converted method. Potentially dilutive securities are excluded from the computations of diluted net loss per share if their effect would be antidilutive. The following potentially dilutive securities have been excluded from the diluted net loss per share calculations because their effect would have been antidilutive (in thousands):

|                                                        | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                 |
|--------------------------------------------------------|---------------------------|-----------------|--------------------------|-----------------|
|                                                        | <b>June</b>               |                 | <b>June</b>              |                 |
|                                                        | <b>29,</b>                | <b>June 30,</b> | <b>29,</b>               | <b>June 30,</b> |
|                                                        | <b>2007</b>               | <b>2006</b>     | <b>2007</b>              | <b>2006</b>     |
| Stock options and warrants                             | 1,167                     | 20,971          | 3,830                    | 13,636          |
| 5.25% convertible subordinated notes due May 2006      |                           | 2,824           |                          | 4,835           |
| 4.25% convertible subordinated notes due May 2006      |                           | 2,428           |                          | 5,718           |
| 4.00% convertible subordinated notes due February 2007 |                           | 10,758          | 4,887                    | 11,564          |
| 4.00% convertible subordinated notes due March 2026    | 50,813                    | 46,457          | 50,813                   | 19,209          |
|                                                        | 51,980                    | 83,438          | 59,530                   | 54,962          |

**Business Enterprise Segments** The Company operates in one reportable segment, broadband communications. SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for the way that public business enterprises report information about operating segments in consolidated financial statements.

Although the Company had four operating segments at June 29, 2007, under the aggregation criteria set forth in SFAS No. 131, the Company only operates in one reportable segment, broadband communications.

Under SFAS No. 131, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles of SFAS No. 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas:

the nature of products and services;

the nature of the production processes;

the type or class of customer for their products and services; and

the methods used to distribute their products or provide their services.

The Company meets each of the aggregation criteria for the following reasons:

the sale of semiconductor products is the only material source of revenue for each of the Company's four operating segments;

the products sold by each of the Company's operating segments use the same standard manufacturing process;

the products marketed by each of the Company's operating segments are sold to similar customers; and

all of the Company's products are sold through its internal sales force and common distributors.

Because the Company meets each of the criteria set forth above and each of its operating segments has similar economic characteristics, the Company aggregates its results of operations in one reportable segment.

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***Recent Accounting Pronouncements*** In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which permits entities to choose to measure at fair value eligible financial instruments and certain other items that are not currently required to be measured at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 no later than the first quarter of fiscal 2009. The Company is currently assessing the impact the adoption of SFAS No. 159 will have on its financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires company plan sponsors to display the net over- or under-funded position of a defined benefit postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations or actuarial gains/losses reported as a component of other comprehensive income in shareholders equity. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. The Company will adopt SFAS No. 158 as of the end of fiscal 2007. The Company is currently assessing the impact the adoption of SFAS No. 158 will have on its financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, clarifies the definition of fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the application of SFAS No. 157 may change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will adopt SFAS No. 157 in the first quarter of fiscal 2009. The Company is currently assessing the impact the adoption of SFAS No. 157 will have on its financial position and results of operations.

In September 2006, the Securities and Exchange Commission issued SAB No. 108 on Quantifying Misstatements. SAB No. 108 requires companies to use both a balance sheet and an income statement approach when quantifying and evaluating the materiality of a misstatement, and contains guidance on correcting errors under the dual approach. SAB No. 108 also provides transition guidance for correcting errors existing in prior years. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged for any interim period of the first fiscal year ending after November 15, 2006, and filed after September 13, 2006. The Company is currently assessing the impact, if any, SAB No. 108 will have on its financial position and results of operations.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the application of SFAS No. 109, Accounting for Income Taxes, by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements and also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, but earlier adoption is permitted. The Company is currently assessing the impact the adoption of FIN 48 will have on its financial position and results of operations. The Company will adopt FIN 48 no later than the first quarter of fiscal 2008.

***Reclassification*** The Company has reclassified its share of the earnings and losses of its equity method investments from other income, net to a separate line item between provision for income taxes and net income (loss) on its statements of operations for the three and nine months ended June 30, 2006 to conform to the current period presentation. This reclassification on the statement of operations did not affect the Company's reported revenues, gross margin, operating loss or net loss for either period. The following is a reconciliation of other income, net before and after the reclassification (in thousands):



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|                                             | <b>Three<br/>Months<br/>Ended<br/><br/>June 30, 2006</b> | <b>Nine Months<br/>Ended<br/>June 30,<br/>2006</b> |
|---------------------------------------------|----------------------------------------------------------|----------------------------------------------------|
| Other expense, net, before reclassification | \$ (49,907)                                              | \$ (6,423)                                         |
| Losses on equity method investments         | 648                                                      | 3,303                                              |
| Other expense, net, after reclassification  | \$ (49,259)                                              | \$ (3,120)                                         |

**2. Business Combination**

In October 2006, the Company acquired the assets of Zarlink Semiconductor Inc. s (Zarlink) packet switching business. Zarlink s team of digital switching logic engineers is now part of the Company s Broadband Access group and is based in the Company s headquarters in Newport Beach, California. This acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. The Company s consolidated statements of operations include the effect of this transaction from the date of acquisition. The pro forma effect of this transaction was not material to the Company s statements of operations for the nine months ended June 29, 2007.

The aggregate purchase price for this acquisition was \$5.0 million. Of this purchase price, approximately \$0.7 million was allocated to net tangible assets, approximately \$2.4 million was allocated to identifiable intangible assets, and the remaining \$1.9 million was allocated to goodwill. The identifiable intangible assets are being amortized on a straight-line basis over their useful lives of eight years. The terms of this acquisition include provisions under which Zarlink could receive additional amounts of up to \$1.5 million through December 31, 2007 and up to \$1.0 million through December 31, 2008 if certain revenue targets are achieved. This contingent consideration has not been included in the purchase price allocation and, if earned, such amounts will be recorded as additional goodwill.

**3. Supplemental Financial Information****Marketable Securities**

Available-for-sale securities consist of the following (in thousands):

|                                   | <b>Cost or<br/>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Losses</b> | <b>Fair<br/>Value</b> |
|-----------------------------------|---------------------------------------|---------------------------------------------------|----------------------------------------------------|-----------------------|
| <b>June 29, 2007:</b>             |                                       |                                                   |                                                    |                       |
| Corporate debt securities         | \$ 2,383                              | \$ 23                                             | \$                                                 | \$ 2,406              |
| U.S. government agency securities | 12,804                                | 151                                               |                                                    | 12,955                |
| Equity securities                 | 44,063                                | 11,376                                            | (4,831)                                            | 50,608                |
|                                   | \$ 59,250                             | \$ 11,550                                         | \$ (4,831)                                         | \$ 65,969             |
| <b>September 29, 2006:</b>        |                                       |                                                   |                                                    |                       |
| Corporate debt securities         | \$ 22,719                             | \$ 30                                             | \$ (29)                                            | \$ 22,720             |
| U.S. government agency securities | 60,777                                | 134                                               | (11)                                               | 60,900                |
| Equity securities                 | 34,068                                |                                                   | (1,979)                                            | 32,089                |

\$ 117,564      \$ 164      \$ (2,019)      \$ 115,709

The Company's marketable equity securities at June 29, 2007 and September 29, 2006 include 6.2 million shares of Skyworks Solutions, Inc. (Skyworks) common stock. The Company's cost basis in the Skyworks shares is \$5.51 per share, and the market value at June 29, 2007 was \$7.35 per share. The Company's marketable equity securities at June 29, 2007 also include 1.7 million shares of Jazz Technologies, Inc. (Jazz Technologies) common stock, which were purchased in February 2007. The Company's cost basis in these shares is \$5.85 per share, and the market value at June 29, 2007 was \$3.02 per share. The \$4.8 million aggregate decrease in the fair value of the Jazz Technologies shares has been recorded in accumulated other comprehensive income (loss) on the Company's consolidated balance sheet at June 29, 2007. Subsequent to June 29, 2007, the Company sold 2.8 million shares of

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its Skyworks common stock. See Note 12 for further information regarding these sales of marketable equity securities.

**Inventories**

Inventories consist of the following (in thousands):

|                 | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|-----------------|--------------------------|-----------------------------------|
| Work-in-process | \$ 23,356                | \$ 53,884                         |
| Finished goods  | 39,962                   | 43,576                            |
|                 | <b>\$ 63,318</b>         | <b>\$ 97,460</b>                  |

At June 29, 2007 and September 29, 2006, inventories were net of excess and obsolete (E&O) inventory reserves of \$22.2 million and \$36.6 million, respectively. In addition, at June 29, 2007 and September 29, 2006, inventories were net of lower of cost or market (LCM) reserves of \$0.3 million and \$1.8 million, respectively.

**Goodwill**

The changes in the carrying amount of goodwill for the nine months ended June 29, 2007 were as follows (in thousands):

|                                |            |
|--------------------------------|------------|
| Goodwill at September 29, 2006 | \$ 710,790 |
| Impairment                     | (135,000)  |
| Additions                      | 1,921      |
| Other adjustments              | 2,983      |
| Goodwill at June 29, 2007      | \$ 580,694 |

Goodwill is tested on an annual basis and between annual tests whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the quarter ended March 30, 2007, major cellular handset manufacturers accelerated their timelines for incorporating the emerging combination Bluetooth-WiFi products into their roadmaps, which decreased the revenue outlook related to the Company's existing design wins. Further, the Company has decided not to pursue the development of these combination products due to the high level of research and development effort required. As a result of these events, the Company reduced its revenue forecast for wireless products targeted at the cellular handset market. Due to this reduced revenue forecast, the Company performed a goodwill impairment test for its Embedded Wireless Networking (EWN) reporting unit during the three months ended March 30, 2007. The fair value of the EWN reporting unit was determined using a combination of a discounted cash flow model and a revenue multiple model. As a result of this impairment test, the Company recorded an impairment charge of \$135.0 million related to the goodwill in its EWN reporting unit. This impairment charge is included in special charges in the accompanying condensed consolidated statements of operations for the nine months ended June 29, 2007.

The Company also recorded \$1.9 million of additional goodwill as a result of the acquisition of the assets of Zarlink's packet switching business in October 2006. See Note 2 for further information regarding the Zarlink acquisition.

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**Intangible Assets**

Intangible assets consist of the following (in thousands):

|                         | <b>June 29, 2007</b>                 |                                     |                       | <b>September 29, 2006</b>            |                                     |                       |
|-------------------------|--------------------------------------|-------------------------------------|-----------------------|--------------------------------------|-------------------------------------|-----------------------|
|                         | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Book<br/>Value</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Book<br/>Value</b> |
| Developed technology    | \$ 125,614                           | \$ (89,778)                         | \$ 35,836             | \$ 139,483                           | \$ (74,477)                         | \$ 65,006             |
| Product licenses        | 9,327                                | (6,298)                             | 3,029                 | 12,769                               | (5,263)                             | 7,506                 |
| Other intangible assets | 6,015                                | (3,757)                             | 2,258                 | 7,015                                | (3,519)                             | 3,496                 |
|                         | <b>\$ 140,956</b>                    | <b>\$ (99,833)</b>                  | <b>\$ 41,123</b>      | <b>\$ 159,267</b>                    | <b>\$ (83,259)</b>                  | <b>\$ 76,008</b>      |

Intangible assets are amortized over a weighted-average period of approximately six years. Annual amortization expense is expected to be as follows (in thousands):

|                      | <b>Remainder<br/>of 2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Thereafter</b> |
|----------------------|------------------------------|-------------|-------------|-------------|-------------|-------------------|
| Amortization expense | \$4,785                      | \$18,853    | \$11,123    | \$4,638     | \$679       | \$1,045           |

Intangible assets are continually monitored and reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Due to the reduced revenue forecast for wireless products discussed above, the Company performed an impairment test for its EWN intangible assets during the three months ended March 30, 2007. The fair values of the intangible assets were determined using a discounted cash flow model. As a result of this impairment test, the Company recorded an impairment charge of \$20.0 million related to the intangible assets in its EWN business, including the 802.11b, 802.11g and 802.11a/b/g developed technologies acquired in its merger with GlobespanVirata, Inc. in February 2004. This impairment charge is included in special charges in the accompanying condensed consolidated statements of operations for the nine months ended June 29, 2007.

**Mindspeed Warrant**

The Company has a warrant to purchase 30 million shares of Mindspeed common stock at an exercise price of \$3.408 per share exercisable through June 2013. At June 29, 2007 and September 29, 2006, the market value of Mindspeed common stock was \$2.21 and \$1.73 per share, respectively. The Company accounts for the Mindspeed warrant as a derivative instrument, and changes in the fair value of the warrant are included in other (income) expense, net each period. At June 29, 2007 and September 29, 2006, the aggregate fair value of the Mindspeed warrant included in other assets on the accompanying condensed consolidated balance sheets was \$24.3 million and \$16.5 million, respectively. At June 29, 2007, the warrant was valued using the Black-Scholes-Merton model with expected terms for portions of the warrant varying from 1 to 5 years, expected volatility of 75%, a weighted-average risk-free interest rate of 5.0% and no dividend yield. The aggregate fair value of the warrant is reflected as a long-term asset on the accompanying condensed consolidated balance sheets because the Company does not intend to liquidate any portion of the warrant in the next twelve months.

The valuation of this derivative instrument is subjective, and option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Changes in these assumptions can materially affect the fair value estimate. The Company could, at any point in time, ultimately realize amounts significantly different than the carrying value.

**Short-Term Debt**

On November 29, 2005, the Company established an accounts receivable financing facility whereby it sells, from time to time, certain accounts receivable to Conexant USA, LLC (Conexant USA), a special purpose entity which is a consolidated subsidiary of the Company. Under the terms of the Company's agreements with Conexant USA, the Company retains the responsibility to service and collect accounts receivable sold to Conexant USA and receives a weekly fee from Conexant USA for handling administrative matters which is equal to 1.0%, on a per annum basis, of the uncollected value of the accounts receivable.

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Concurrent with the Company's agreements with Conexant USA, Conexant USA entered into an \$80.0 million revolving credit agreement with a bank which is secured by the assets of Conexant USA. This credit agreement had an initial term of 364 days, and in November 2006, the term of the credit agreement was extended through November 28, 2007. The credit agreement remains subject to additional 364-day renewal periods at the discretion of the bank.

Conexant USA is required to maintain certain minimum amounts on deposit (restricted cash) with the bank during the term of the credit agreement. Borrowings under the credit agreement, which cannot exceed the lesser of \$80.0 million and 85% of the uncollected value of purchased accounts receivable that are eligible for coverage under an insurance policy for the receivables, bear interest equal to 7-day LIBOR (reset quarterly) plus 0.6%. Additionally, Conexant USA pays a fee of 0.2% per annum for the unused portion of the line of credit.

The credit agreement requires the Company and its consolidated subsidiaries to maintain minimum levels of shareholders' equity and cash and cash equivalents. Further, any failure by the Company or Conexant USA to pay their respective debts as they become due would allow the bank to terminate the credit agreement and cause all borrowings under the credit agreement to immediately become due and payable. At June 29, 2007, Conexant USA had \$5.8 million of cash, \$8.8 million of restricted cash and \$83.4 million of accounts receivable, all of which serve as collateral under the credit agreement. At June 29, 2007, Conexant USA had borrowed \$80.0 million under this credit agreement and the Company was in compliance with all financial covenants. During the nine months ended June 29, 2007, the Company incurred fees of \$1.2 million in connection with the extension of the credit agreement.

**Long-Term Debt**

Long-term debt consists of the following (in thousands):

|                                                        | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|--------------------------------------------------------|--------------------------|-----------------------------------|
| Floating rate senior secured notes due November 2010   | \$ 275,000               | \$                                |
| 4.00% convertible subordinated notes due March 2026    | 250,000                  | 250,000                           |
| 4.00% convertible subordinated notes due February 2007 |                          | 456,500                           |
| Total                                                  | 525,000                  | 706,500                           |
| Less: current portion of long-term debt                | (43,900)                 | (188,375)                         |
| Long-term debt                                         | \$ 481,100               | \$ 518,125                        |

***Floating rate senior secured notes due November 2010*** In November 2006, the Company issued \$275.0 million aggregate principal amount of floating rate senior secured notes due November 2010. Proceeds from this issuance, net of fees paid or payable, were approximately \$264.9 million. The senior secured notes bear interest at three-month LIBOR (reset quarterly) plus 3.75%, and interest is payable in arrears quarterly on each February 15, May 15, August 15 and November 15, beginning on February 15, 2007. The senior secured notes are redeemable in whole or in part, at the option of the Company, at any time on or after November 15, 2008 at varying redemption prices that generally include premiums, which are defined in the indenture for the notes, plus accrued and unpaid interest. At any time prior to November 15, 2008, the Company may redeem up to 35% of the senior secured notes with proceeds of one or more offerings of the Company's common stock at a redemption price equal to 100% of the aggregate principal amount thereof plus accrued and unpaid interest. The Company is required to offer to repurchase, for cash, notes at a price of 100% of the principal amount, plus any accrued and unpaid interest, with the net proceeds of certain asset dispositions if such proceeds are not used within 360 days to invest in assets (other than current assets) related to the Company's business. In addition, upon a change of control, the Company is required to make an offer to redeem all of the senior secured notes at a redemption price equal to 101% of the aggregate principal amount thereof plus accrued

and unpaid interest. The floating rate senior secured notes rank equally in right of payment with all of the Company's existing and future senior debt and senior to all of its existing and future subordinated debt. The notes are guaranteed by certain of the Company's U.S. subsidiaries (the Subsidiary Guarantors). The guarantees rank equally in right of payment with all of the Subsidiary Guarantors' existing and future senior debt and senior to all of the Subsidiary Guarantors' existing and future subordinated debt. The notes and guarantees (and certain hedging obligations that may be entered into with respect thereto) are secured by first-

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priority liens, subject to permitted liens, on substantially all of the Company's and the Subsidiary Guarantors' assets (other than accounts receivable and proceeds therefrom and subject to certain exceptions), including, but not limited to, the intellectual property, owned real property, plant and equipment now owned or hereafter acquired by the Company and the Subsidiary Guarantors. See Note 11 for condensed financial information regarding the Subsidiary Guarantors.

The indenture governing the senior secured notes contains a number of covenants that restrict, subject to certain exceptions, the Company's ability and the ability of its restricted subsidiaries to: incur or guarantee additional indebtedness or issue certain redeemable or preferred stock; repurchase capital stock; pay dividends on or make other distributions in respect of its capital stock or make other restricted payments; make certain investments; create liens; redeem junior debt; sell certain assets; consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; enter into certain types of transactions with affiliates; and enter into sale-leaseback transactions.

The sale of the Company's investment in Jazz Semiconductor Inc. (Jazz Semiconductor) in February 2007 and the sale of two other equity investments in January 2007 qualify as asset dispositions requiring the Company to make offers to repurchase a portion of the notes no later than 361 days following the respective asset dispositions. Based on the proceeds received from these asset dispositions and the Company's estimates of cash investments in assets (other than current assets) related to the Company's business to be made within 360 days following the asset dispositions, the Company estimates that it will be required to make offers to repurchase approximately \$43.9 million of the senior secured notes, at 100% of the principal amount plus any accrued and unpaid interest, in the second quarter of fiscal 2008. As a result, \$43.9 million of the senior secured notes have been classified as current liabilities on the accompanying condensed consolidated balance sheet at June 29, 2007.

At June 29, 2007, the fair value of the floating rate senior secured notes, based on quoted market prices, was approximately \$280.5 million compared to their carrying value of \$275.0 million.

**4.00% convertible subordinated notes due March 2026** In March 2006, the Company issued \$200.0 million aggregate principal amount of 4.00% convertible subordinated notes due March 2026 and, in May 2006, the initial purchaser of the notes exercised its option to purchase an additional \$50.0 million principal amount of the 4.00% convertible subordinated notes due March 2026. Total proceeds from these issuances, net of issuance costs, were approximately \$243.6 million. The notes are general unsecured obligations of the Company. Interest on the notes is payable in arrears semiannually on each March 1 and September 1, beginning on September 1, 2006. The notes are convertible, at the option of the holder upon satisfaction of certain conditions, into shares of the Company's common stock at a conversion price of \$4.92 per share, subject to adjustment for certain events. Upon conversion, the Company has the right to deliver, in lieu of common stock, cash or a combination of cash and common stock. Beginning on March 1, 2011, the notes may be redeemed at the Company's option at a price equal to 100% of the principal amount, plus any accrued and unpaid interest. Holders may require the Company to repurchase, for cash, all or part of their notes on March 1, 2011, March 1, 2016 and March 1, 2021 at a price of 100% of the principal amount, plus any accrued and unpaid interest.

At June 29, 2007, the fair value of the 4.00% convertible subordinated notes due March 2026, based on quoted market prices, was approximately \$216.3 million compared to their carrying value of \$250.0 million.

**4.00% convertible subordinated notes due February 2007** In February 2000, the Company issued \$650.0 million aggregate principal amount of 4.00% convertible subordinated notes due February 2007 for proceeds, net of issuance costs, of approximately \$631.0 million. The notes were general unsecured obligations of the Company. Interest on the notes was payable in arrears semiannually on each February 1 and August 1. The notes were convertible, at the option of the holder, at any time prior to redemption or maturity into shares of the Company's common stock at a conversion price of \$42.43 per share, subject to adjustment for certain events. The notes were subject to redemption at the Company's option at a declining premium to par. During fiscal 2001, 2003 and 2006, the Company purchased \$35.0 million, \$100.0 million and \$58.5 million, respectively, principal amount of these notes at prevailing market prices. In February 2007, the Company retired the remaining \$456.5 million principal amount of these notes at

maturity.

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**4. Commitments and Contingencies****Lease Commitments**

The Company leases certain facilities and equipment under non-cancelable operating leases which expire at various dates through 2021 and contain various provisions for rental adjustments including, in certain cases, adjustments based on increases in the Consumer Price Index. The leases generally contain renewal provisions for varying periods of time. Rental expense under operating leases was approximately \$9.6 million and \$11.9 million for the nine months ended June 29, 2007 and June 30, 2006, respectively.

At June 29, 2007, future minimum lease payments and related sublease income under operating leases were as follows (in thousands):

| <b>Fiscal Year</b> | <b>Lease<br/>Payments</b> | <b>Sublease<br/>Income</b> | <b>Net<br/>Obligation</b> |
|--------------------|---------------------------|----------------------------|---------------------------|
| Remainder of 2007  | \$ 7,485                  | \$ (2,165)                 | \$ 5,320                  |
| 2008               | 26,290                    | (7,167)                    | 19,123                    |
| 2009               | 18,814                    | (3,384)                    | 15,430                    |
| 2010               | 17,371                    | (3,330)                    | 14,041                    |
| 2011               | 14,791                    | (2,178)                    | 12,613                    |
| Thereafter         | 64,590                    | (5,582)                    | 59,008                    |
| <b>Total</b>       | <b>\$ 149,341</b>         | <b>\$ (23,806)</b>         | <b>\$ 125,535</b>         |

The summary of future minimum lease payments includes an aggregate gross amount of \$52.8 million of lease obligations that principally expire through fiscal 2021, which have been accrued for in connection with the Company's reorganization and restructuring actions and previous actions taken by GlobespanVirata, Inc. prior to its merger with the Company in February 2004. See Note 7 for further information regarding restructuring actions.

At June 29, 2007, the Company is also contingently liable for approximately \$3.4 million in operating lease commitments on facility leases that were assigned to Mindspeed and Skyworks at the time of their separation from the Company.

**Contingencies**

Under the terms of the Zarlink acquisition, the Company may be required to pay additional amounts of up to \$1.5 million through December 31, 2007 and up to \$1.0 million through December 31, 2008 if certain revenue targets are achieved. See Note 2 for further information regarding the Zarlink acquisition.

**Legal Matters**

Certain claims have been asserted against the Company, including claims alleging the use of the intellectual property rights of others in certain of the Company's products. The resolution of these matters may entail the negotiation of a license agreement, a settlement, or the adjudication of such claims through arbitration or litigation. The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably for the Company. Many intellectual property disputes have a risk of injunctive relief and there can be no assurance that a license will be granted. Injunctive relief could have a material adverse effect on the financial condition or results of operations of the Company. Based on its evaluation of matters which are pending or asserted and taking into account the Company's reserves for such matters, management believes the disposition of such matters will not have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

**IPO Litigation** In November 2001, Collegeware Asset Management, LP, on behalf of itself and a putative class of persons who purchased the common stock of GlobeSpan, Inc. (GlobeSpan, Inc. later became GlobespanVirata, Inc., and is now the Company's Conexant, Inc. subsidiary) between June 23, 1999 and December 6, 2000, filed a complaint in the U.S. District Court for the Southern District of New York alleging violations of federal securities laws by the

underwriters of GlobeSpan, Inc. s initial and secondary public offerings as well as by certain

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GlobeSpan, Inc. officers and directors. The complaint alleges that the defendants violated federal securities laws by issuing and selling GlobeSpan, Inc.'s common stock in the initial and secondary offerings without disclosing to investors that the underwriters had (1) solicited and received undisclosed and excessive commissions or other compensation and (2) entered into agreements requiring certain of their customers to purchase the stock in the aftermarket at escalating prices. The complaint seeks unspecified damages. The complaint was consolidated with class actions against approximately 300 other companies making similar allegations regarding the public offerings of those companies during 1998 through 2000. A tentative settlement was reached in 2003. As contemplated by the settlement agreement, the District Court then certified a class, for settlement purposes only. The tentative settlement was abandoned in 2007, in light of a decision of the U.S. Court of Appeals for the Second Circuit vacating orders certifying similarly-defined classes in cases against the underwriters. The Company does not believe the ultimate outcome of this litigation will have a material adverse impact on its financial condition, results of operations, or cash flows.

**Class Action Suits** In December 2004 and January 2005, the Company and certain of its current and former officers and directors were named as defendants in several complaints seeking monetary damages filed on behalf of all persons who purchased the Company's common stock during a specified class period. These suits were filed in the U.S. District Court of New Jersey (New Jersey cases) and the U.S. District Court for the Central District of California (California cases), alleging that the defendants violated the Securities Exchange Act of 1934, as amended, by allegedly disseminating materially false and misleading statements and/or concealing material adverse facts. The California cases were consolidated with the New Jersey cases so that all of the class action suits, now known as *Witriol v. Conexant, et al.* (*Witriol*), were heard in the U.S. District Court of New Jersey by the same judge. On September 1, 2005, the defendants filed their motion to dismiss the case. On November 23, 2005, the court granted the plaintiffs' motion to file a second amended complaint, which was filed on December 5, 2005. The defendants filed an amended motion to dismiss the case on February 6, 2006. Plaintiffs filed their opposition on April 24, 2006, and defendants' reply was filed on June 14, 2006. On December 4, 2006, the court dismissed the second amended complaint. Two of the three claims were dismissed with prejudice, while the third claim was dismissed without prejudice. On January 10, 2007, the parties filed a stipulation and tolling agreement with the court stating that plaintiffs would not file an appeal of the ruling dismissing two claims with prejudice and the defendants agreed to give plaintiffs' counsel until March 16, 2007 to file an amended complaint with respect to the third claim. On April 9, 2007, the Company and the named plaintiff agreed to settle the case as to all defendants for \$90,000, to be paid by the Company within 30 days of the execution of a written agreement. The settlement is now complete and the case has been dismissed in its entirety.

In addition, in February 2005, the Company and certain of its current and former officers and the Company's Employee Benefits Plan Committee were named as defendants in *Graden v. Conexant, et al.*, a lawsuit filed on behalf of all persons who were participants in the Company's 401(k) Plan (Plan) during a specified class period. This suit was filed in the U.S. District Court of New Jersey and alleges that the defendants breached their fiduciary duties under the Employee Retirement Income Security Act, as amended, to the Plan and the participants in the Plan. The plaintiff filed an amended complaint on August 11, 2005. On October 12, 2005, the defendants filed a motion to dismiss this case contending that plaintiff lacked statutory standing. The plaintiff responded to the motion to dismiss on December 30, 2005, and the defendants' reply was filed on February 17, 2006. On March 31, 2006, the judge dismissed this case and ordered it closed. Plaintiff filed a notice of appeal on April 17, 2006. The appellate argument was held on April 19, 2007. On July 31, 2007, the Third Circuit Court of Appeals vacated the District Court's order dismissing *Graden's* complaint and remanded the case for further proceedings. The Company believes the lawsuit is without merit and will vigorously defend the case.

**Shareholder Derivative Suits** In January 2005, the Company and certain of its current and former directors and officers were named as defendants in purported shareholder derivative actions seeking monetary damages (now consolidated) in the California Superior Court for the County of Orange, alleging that the defendants breached their

fiduciary duties, abused control, mismanaged the Company, wasted corporate assets and unjustly enriched themselves. A similar lawsuit was filed in the U.S. District Court of New Jersey in May 2005. On July 28, 2005, the California court approved a stay of the actions filed in California pending the outcome of the motion to dismiss in the *Witriol* case. The Company negotiated a similar stay agreement with the plaintiffs in the New Jersey case, which was approved by the District Court in New Jersey. Pursuant to the stay agreements, in the event that the parties in the *Witriol* case engaged in any negotiations, plaintiffs' counsel in the derivative cases were to be kept

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informed. On February 2, 2007, the District Court in New Jersey ordered a dismissal of the New Jersey case after the parties filed a stipulation to dismiss. On March 20, 2007, the California derivative suit was also voluntarily dismissed.

**Guarantees and Indemnifications**

The Company has made guarantees and indemnities, under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions. In connection with the Company's spin-off from Rockwell International Corporation, the Company assumed responsibility for all contingent liabilities and then-current and future litigation (including environmental and intellectual property proceedings) against Rockwell or its subsidiaries in respect of the operations of the semiconductor systems business of Rockwell. In connection with the Company's contribution of certain of its manufacturing operations to Jazz Semiconductor, the Company agreed to indemnify Jazz Semiconductor for certain environmental matters and other customary divestiture-related matters. In connection with the sales of its products, the Company provides intellectual property indemnities to its customers. In connection with certain facility leases, the Company has indemnified its lessors for certain claims arising from the facility or the lease. The Company indemnifies its directors and officers to the maximum extent permitted under the laws of the State of Delaware.

The durations of the Company's guarantees and indemnities vary, and in many cases are indefinite. The guarantees and indemnities to customers in connection with product sales generally are subject to limits based upon the amount of the related product sales. The majority of other guarantees and indemnities do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. The Company has not recorded any liability for these guarantees and indemnities in the accompanying condensed consolidated balance sheets. Product warranty costs are not significant.

**Other**

**Tax Matter** In the three months ended March 30, 2007, the Company received a letter from a foreign jurisdiction proposing certain tax assessments related to an acquired foreign subsidiary. The proposed assessments cover both pre- and post-acquisition periods. The Company has been contractually indemnified for any assessments related to the pre-acquisition period, and management does not believe any assessments related to the post-acquisition period will be material.

**India Fringe Benefit Tax** In May 2007 the government of India enacted legislation imposing a Fringe Benefit Tax ( India FBT ) on gains generated on stock compensation earned by citizens of India. The India FBT of 33.9% is the obligation of the employer and applies to restricted stock awards, employee stock purchase plans and stock option awards. The India FBT for gains related to restricted stock awards are imposed upon vesting. For employee stock purchase plans, the India FBT is imposed on the purchase date. For employee stock options, the India FBT is assessed based upon the intrinsic value upon vesting, but is not payable until the exercise of the option. The legislation permits employers to pass the cost of the India FBT to employees. The Company accrued an estimated liability associated with the India FBT of \$0.1 million as of June 29, 2007.

**Environmental Remediation** The Company has been designated as a potentially responsible party and is engaged in groundwater remediation under a previously approved Consent Decree at one Superfund site located at a former silicon wafer manufacturing facility and steel fabrication plant in Parker Ford, Pennsylvania formerly occupied by the Company, which has been settled pursuant to a Consent Decree entered into with the Environmental Protection Agency in August 2006. In addition, the Company is engaged in remediation of groundwater contamination at its former Newport Beach, California wafer fabrication facility. As of June 29, 2007, the Company has an accrual of \$1.2 million for the estimated remaining costs of these remediations.

**Capital Investments** In connection with certain non-marketable equity investments, with carrying values totaling \$6.7 million, the Company may be required to invest up to an additional \$3.6 million as of June 29, 2007. These additional investments are subject to capital calls, and a decision by the Company not to participate could result in an impairment of the existing investments.



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**5. Shareholders' Equity**

The Company's authorized capital consists of 1,000,000,000 shares of common stock, par value \$0.01 per share, and 25,000,000 shares of preferred stock, without par value, of which 5,000,000 shares are designated as Series A junior participating preferred stock (the Junior Preferred Stock).

The Company has a preferred share purchase rights plan to protect shareholders' rights in the event of a proposed takeover of the Company. A preferred share purchase right (a Right) is attached to each share of common stock pursuant to which the holder may, in certain takeover-related circumstances, become entitled to purchase from the Company 1/200<sup>th</sup> of a share of Junior Preferred Stock at a price of \$300, subject to adjustment. Also, in certain takeover-related circumstances, each Right (other than those held by an acquiring person) will generally be exercisable for shares of the Company's common stock or stock of the acquiring person having a market value of twice the exercise price. In certain events, each Right may be exchanged by the Company for one share of common stock or 1/200<sup>th</sup> of a share of Junior Preferred Stock. The Rights expire on December 31, 2008, unless earlier exchanged or redeemed at a redemption price of \$0.01 per Right, subject to adjustment.

**Stock Option Plans**

The Company has stock option plans and long-term incentive plans under which employees and directors may be granted options to purchase shares of the Company's common stock. As of June 29, 2007, approximately 54.1 million shares of the Company's common stock are available for grant under the stock option and long-term incentive plans. Stock options are generally granted with exercise prices of not less than the fair market value at grant date, generally vest over four years and expire eight or ten years after the grant date. The Company settles stock option exercises with newly issued shares of common stock. The Company has also assumed stock option plans in connection with business combinations.

A summary of stock option activity is as follows (shares in thousands):

|                                 | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|---------------------------------|---------------|----------------------------------------------------|
| Outstanding, September 29, 2006 | 103,782       | \$2.65                                             |
| Granted                         | 14,740        | 1.48                                               |
| Exercised                       | (3,358)       | 1.41                                               |
| Canceled                        | (14,045)      | 3.23                                               |
| Outstanding, June 29, 2007      | 101,119       | 2.44                                               |
| Exercisable, June 29, 2007      | 69,901        | 2.69                                               |

At June 29, 2007, of the 101.1 million stock options outstanding, approximately 81.6 million options were held by current employees and directors of the Company, and approximately 19.5 million options were held by employees of Rockwell, a former Rockwell business, or a former business of the Company (i.e., Mindspeed, Skyworks, Jazz Semiconductor) who remain employed by one of these businesses. At June 29, 2007, the options outstanding had an aggregate intrinsic value of \$0.4 million and a weighted-average remaining contractual term of 4.5 years. At June 29, 2007, the options exercisable had an aggregate intrinsic value of \$0.3 million and a weighted-average remaining contractual term of 3.4 years.

The weighted-average grant date fair value of options granted during the nine months ended June 29, 2007 was \$0.72 per share. The total intrinsic value of options exercised during the nine months ended June 29, 2007 was \$2.1 million.

The total cash received from employees as a result of stock option exercises was \$4.8 million for the nine months ended June 29, 2007.

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At June 29, 2007, the total unrecognized fair value compensation cost related to unvested stock options and employee stock purchase plan awards was \$21.2 million, which is expected to be recognized over a remaining weighted-average period of approximately 2.6 years.

**Directors Stock Plan**

The Company has a Directors Stock Plan (DSP) which provides for each non-employee director to receive specified levels of stock option grants upon election to the Board of Directors and periodically thereafter. Under the DSP, each non-employee director may elect to receive all or a portion of the cash retainer to which the director is entitled through the issuance of common stock. During the nine months ended June 29, 2007, 80,000 stock options were granted under the DSP. At June 29, 2007, approximately 0.8 million shares of the Company's common stock are available for grant under the DSP.

**Employee Stock Purchase Plan**

The Company has an employee stock purchase plan (ESPP) which allows eligible employees to purchase shares of the Company's common stock at six-month intervals during an offering period at 85% of the lower of the fair market value on the first day of the offering period or on the purchase date. Under the ESPP, employees may authorize the Company to withhold up to 15% of their compensation for each pay period to purchase shares under the plan, subject to certain limitations, and employees are limited to the purchase of 2,000 shares per offering period. Offering periods generally commence on the first trading day of February and August of each year and are generally six months in duration, but may be terminated earlier under certain circumstances. During the nine months ended June 29, 2007, the Company issued approximately 1.9 million shares of common stock under the ESPP for total proceeds of \$2.8 million. At June 29, 2007, approximately 21.6 million shares of the Company's common stock are reserved for future issuance under the ESPP, of which 15.0 million shares will become available in 2.5 million share annual increases, subject to the Board of Directors selecting a lower amount.

**Performance Share Plan**

The Company has a Performance Share Plan under which it originally reserved 4.0 million shares for issuance. Vested performance share awards may be settled, at the Company's election at the time of payment, in cash, shares of common stock or any combination of cash and common stock. On November 15, 2006, the Company issued shares of common stock with a fair market value of \$2.29 per share to an executive in satisfaction of his fiscal 2006 performance share award granted under his employment agreement. The total fair market value of the award was \$0.6 million and was paid with 149,187 shares of common stock and cash.

At June 29, 2007, approximately 2.2 million shares of the Company's common stock are available for issuance under this plan, excluding approximately 0.9 million shares reserved for issuance under outstanding performance share awards.

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**6. Comprehensive Income (Loss)**

Comprehensive income (loss) consists of the following (in thousands):

|                                                                                  | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|----------------------------------------------------------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                                                                  | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| Net loss                                                                         | \$ (35,227)               | \$ (67,090)              | \$ (167,697)             | \$ (101,493)             |
| Other comprehensive income (loss):                                               |                           |                          |                          |                          |
| Currency translation adjustments                                                 | 887                       | (226)                    | 5,391                    | (933)                    |
| Unrealized gains (losses) on marketable securities                               | 7,661                     | (7,703)                  | 14,405                   | (8,994)                  |
| Unrealized gains on foreign currency forward hedge contracts                     | 45                        | 82                       | 417                      | 82                       |
| Reclassification adjustment for realized losses on available-for-sale securities |                           | 18,456                   |                          | 18,456                   |
| Minimum pension liability adjustments                                            | 56                        | 80                       | 165                      | 232                      |
| Other comprehensive income                                                       | 8,649                     | 10,689                   | 20,378                   | 8,843                    |
| Comprehensive loss                                                               | \$ (26,578)               | \$ (56,401)              | \$ (147,319)             | \$ (92,650)              |

Included in unrealized gains (losses) on marketable securities for the nine months ended June 29, 2007 is a \$5.8 million unrealized gain relating to the sale of Jazz Semiconductor to Acquiror Technology Inc. (now Jazz Technologies). This gain has been deferred as a result of the Company's on-going investment in Jazz Technologies. See Note 9 for further discussion of the sale of Jazz Semiconductor.

Accumulated other comprehensive income (loss) consists of the following (in thousands):

|                                                              | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|--------------------------------------------------------------|--------------------------|-----------------------------------|
| Currency translation adjustments                             | \$ 1,595                 | \$ (3,796)                        |
| Unrealized gains (losses) on marketable securities           | 12,550                   | (1,855)                           |
| Unrealized gains on foreign currency forward hedge contracts | 597                      | 180                               |
| Minimum pension liability adjustments                        | (6,460)                  | (6,625)                           |
| Accumulated other comprehensive income (loss)                | \$ 8,282                 | \$ (12,096)                       |

**7. Special Charges**

Special charges (credits) consist of the following (in thousands):

|                   | <b>Three Months Ended</b>    |                          | <b>Nine Months Ended</b> |                          |
|-------------------|------------------------------|--------------------------|--------------------------|--------------------------|
|                   | <b>June<br/>29,<br/>2007</b> | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| Asset impairments | \$ 3,415                     | \$                       | \$ 158,415               | \$ 85                    |

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|                                 |          |           |            |           |
|---------------------------------|----------|-----------|------------|-----------|
| Restructuring charges           | 1,656    | 2,610     | 8,053      | 2,394     |
| Litigation charges              |          | 30,000    |            | 70,000    |
| Other special charges (credits) |          |           | 1,622      | (100)     |
|                                 | \$ 5,071 | \$ 32,610 | \$ 168,090 | \$ 72,379 |

**Asset Impairments**

During the three months ended June 29, 2007, the Company recorded a \$3.4 million asset impairment charge related to the early termination of an IP license agreement. During the nine months ended June 29, 2007, the Company recorded non-cash goodwill and intangible asset impairment charges of \$135.0 million and \$20.0 million,

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respectively, related to the Company's EWN business and a \$3.4 million impairment charge for the early termination of an IP license agreement. See Note 3 for further information regarding the goodwill and intangible asset impairment charges.

**Restructuring Charges**

The Company has implemented a number of cost reduction initiatives since late fiscal 2001 to improve its operating cost structure. These cost reduction initiatives have included workforce reductions and the closure or consolidation of certain facilities, among other actions. The costs and expenses associated with the restructuring activities, except for costs associated with the employees and facilities of GlobespanVirata, Inc., are included in special charges in the Company's consolidated statements of operations. The costs that related to the employees and facilities of GlobespanVirata have been recorded as acquired liabilities in the merger and included as part of the purchase price allocation. In May 2004, the GlobespanVirata subsidiary was renamed Conexant, Inc.

*Fiscal 2007 Restructuring Actions* During fiscal 2007, the Company announced a facility closure and workforce reductions. During the nine months ended June 29, 2007, the Company has notified approximately 150 employees of their involuntary termination, recorded \$6.7 million of total charges for the cost of severance benefits for the affected employees and recorded \$0.1 million associated with facility closure-related actions.

Activity and liability balances recorded as part of the Fiscal 2007 Restructuring Actions during the nine months ended June 29, 2007 were as follows (in thousands):

|                                          | <b>Workforce<br/>Reductions</b> | <b>Facility<br/>And<br/>Other</b> | <b>Total</b> |
|------------------------------------------|---------------------------------|-----------------------------------|--------------|
| Charged to costs and expenses            | \$ 2,027                        | \$                                | \$ 2,027     |
| Cash payments                            | (214)                           |                                   | (214)        |
| Restructuring balance, December 29, 2006 | 1,813                           |                                   | 1,813        |
| Charged to costs and expenses            | 3,218                           |                                   | 3,218        |
| Cash payments                            | (1,276)                         |                                   | (1,276)      |
| Restructuring balance, March 30, 2007    | 3,755                           |                                   | 3,755        |
| Charged to costs and expenses            | 1,435                           | 98                                | 1,533        |
| Cash payments                            | (2,121)                         | (74)                              | (2,195)      |
| Restructuring balance, June 29, 2007     | \$ 3,069                        | \$ 24                             | \$ 3,093     |

*Fiscal 2006 Restructuring Actions* In fiscal 2006, the Company announced facility closures and workforce reductions. In total, the Company notified approximately 130 employees of their involuntary termination.

Activity and liability balances recorded as part of the Fiscal 2006 Restructuring Actions during the nine months ended June 29, 2007 were as follows (in thousands):

|                                           | <b>Workforce<br/>Reductions</b> | <b>Facility<br/>and<br/>Other</b> | <b>Total</b> |
|-------------------------------------------|---------------------------------|-----------------------------------|--------------|
| Restructuring balance, September 29, 2006 | \$ 1,216                        | \$ 392                            | \$ 1,608     |
| Charged to costs and expenses             | 533                             | 5                                 | 538          |
| Cash payments                             | (951)                           | (48)                              | (999)        |

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|                                          |        |        |        |
|------------------------------------------|--------|--------|--------|
| Restructuring balance, December 29, 2006 | 798    | 349    | 1,147  |
| Charged (credited) to costs and expenses | (200)  | 45     | (155)  |
| Cash payments                            | (191)  | (129)  | (320)  |
| Restructuring balance, March 30, 2007    | 407    | 265    | 672    |
| Charged (credited) to costs and expenses | (169)  | 5      | (164)  |
| Cash payments                            | (30)   | (42)   | (72)   |
| Restructuring balance, June 29, 2007     | \$ 208 | \$ 228 | \$ 436 |

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*Fiscal 2005 Restructuring Action* In November 2004, the Company announced plans to further reduce its operating expense level by the end of 2005. The components of this plan were a shift of product development resources to lower-cost regions and cost savings from continued merger-related sales, general and administrative consolidation. During fiscal 2005, the Company announced several facility closures and workforce reductions. In total, the Company notified approximately 255 employees of their involuntary termination, including approximately 175 domestic and 80 international employees.

Activity and liability balances recorded as part of the Fiscal 2005 Restructuring Action during the nine months ended June 29, 2007 were as follows (in thousands):

|                                           | <b>Workforce<br/>Reductions</b> | <b>Facility<br/>and Other</b> | <b>Total</b> |
|-------------------------------------------|---------------------------------|-------------------------------|--------------|
| Restructuring balance, September 29, 2006 | \$ 196                          | \$ 15,288                     | \$ 15,484    |
| Charged to costs and expenses             |                                 | 311                           | 311          |
| Cash payments                             | (141)                           | (1,190)                       | (1,331)      |
| Restructuring balance, December 29, 2006  | 55                              | 14,409                        | 14,464       |
| Charged to costs and expenses             |                                 | 430                           | 430          |
| Cash payments                             | (5)                             | (985)                         | (990)        |
| Restructuring balance, March 30, 2007     | 50                              | 13,854                        | 13,904       |
| Charged to costs and expenses             |                                 | 287                           | 287          |
| Cash payments                             | (7)                             | (725)                         | (732)        |
| Restructuring balance, June 29, 2007      | \$ 43                           | \$ 13,416                     | \$ 13,459    |

*Fiscal 2004 and Prior Years Restructuring Actions* The Company initiated several restructuring actions during fiscal 2004, 2003 and 2002 as a result of (i) its merger with GlobespanVirata, (ii) lower than anticipated revenue levels, (iii) the divestiture of its Newport Beach wafer fabrication operations, and (iv) the spin-off and merger of its wireless communications business with Alpha Industries, Inc. to form Skyworks. These actions included workforce reductions and facilities closures.

Activity and liability balances recorded as part of these restructuring actions during the nine months ended June 29, 2007 were as follows (in thousands):

|                                                                     | <b>Facility<br/>and Other</b> |
|---------------------------------------------------------------------|-------------------------------|
| Restructuring balance, September 29, 2006                           | \$ 2,971                      |
| Charged to costs and expenses                                       | 22                            |
| Reclassification to other current liabilities and other liabilities | (2,687)                       |
| Cash payments                                                       | (296)                         |
| Restructuring balance, December 29, 2006                            | 10                            |
| Charged to costs and expenses                                       | 6                             |
| Cash payments                                                       | (16)                          |
| Restructuring balance, March 30, 2007 and June 29, 2007             | \$                            |

As of June 29, 2007, the Company has remaining restructuring accruals of \$17.0 million, of which \$3.3 million relates to workforce reductions and \$13.7 million relates to facility and other costs. Of the \$17.0 million of restructuring accruals at June 29, 2007, \$5.8 million is included in other current liabilities and \$11.2 million is included in other non-current liabilities in the accompanying condensed consolidated balance sheet as of June 29, 2007. The Company expects to pay the amounts accrued for the workforce reductions through fiscal 2008 and expects to pay the obligations for the non-cancelable facility lease and other commitments over their respective terms, which expire at various dates through fiscal 2021. Cash payments to complete the restructuring actions will be funded from available cash reserves and funds from product sales, and are not expected to significantly impact the Company's liquidity.

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**Litigation Charges**

During the three and nine months ended June 30, 2006, the Company recorded charges totaling \$30.0 million and \$70.0 million, respectively, related to its litigation with Texas Instruments Incorporated (Texas Instruments). This case was settled in the third quarter of fiscal 2006 for \$70.0 million.

**8. Other Income (Expense), Net**

Other income (expense), net consists of the following (in thousands):

|                                                             | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                 |
|-------------------------------------------------------------|---------------------------|-----------------|--------------------------|-----------------|
|                                                             | <b>June</b>               |                 | <b>June</b>              |                 |
|                                                             | <b>29,</b>                | <b>June 30,</b> | <b>29,</b>               | <b>June 30,</b> |
|                                                             | <b>2007</b>               | <b>2006</b>     | <b>2007</b>              | <b>2006</b>     |
| Investment and interest income                              | \$ 2,110                  | \$ 4,518        | \$ 11,299                | \$ 14,415       |
| Increase (decrease) in fair value of derivative instruments | 944                       | (35,131)        | 7,868                    | (3,800)         |
| Impairment of equity securities                             |                           | (18,456)        |                          | (18,456)        |
| Gains on investments in equity securities                   | 101                       |                 | 6,570                    | 4,414           |
| Other                                                       | 501                       | (190)           | 640                      | 307             |
|                                                             | \$ 3,656                  | \$ (49,259)     | \$ 26,377                | \$ (3,120)      |

Other income (expense), net during the three months ended June 29, 2007 was primarily comprised of \$2.1 million of investment and interest income on invested cash balances and a \$0.9 million increase in the fair value of the Company's warrant to purchase 30 million shares of Mindspeed common stock mainly due to an increase in Mindspeed's stock price during the period. Other income (expense), net during the nine months ended June 29, 2007 was primarily comprised of \$11.3 million of investment and interest income on invested cash balances, a \$7.9 million increase in the fair value of the Company's warrant to purchase 30 million shares of Mindspeed common stock mainly due to an increase in Mindspeed's stock price during the period, and \$6.6 million of gains on investments in equity securities.

Other income (expense), net during the three months ended June 30, 2006, consisted primarily of a \$35.1 million decrease in the fair value of the Company's warrant to purchase 30 million shares of Mindspeed common stock mainly due to a decrease in Mindspeed's stock price during the period and an \$18.5 million charge for the impairment of the Company's Skyworks shares, partially offset by \$4.5 million of investment and interest income on invested cash balances. Other income (expense), net for the nine months ended June 30, 2006, was primarily comprised of an \$18.5 million charge for the impairment of the Company's Skyworks shares and a \$3.8 million decrease in the fair value of the Company's warrant to purchase 30 million shares of Mindspeed common stock mainly due to a decrease in Mindspeed's stock price during the period. These expenses were partially offset by \$14.4 million of investment and interest income on invested cash balances and \$4.4 million of gains on investments in equity securities.

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**9. Related Party Transactions**

**Jazz Technologies, Inc.**

In February 2007, the Company sold its approximate 42% ownership interest in Jazz Semiconductor to Acquiror Technology Inc., which was renamed Jazz Technologies, Inc. after the transaction, and Jazz Semiconductor became a wholly-owned subsidiary of Jazz Technologies. The Company received proceeds of \$98.1 million and recorded an escrow receivable of \$6.8 million as a result of this transaction. Immediately prior to the closing of the sale of Jazz Semiconductor, the Company made an equity investment of \$10.0 million in Acquiror Technology Inc. and acquired 1.7 million shares of Jazz Technologies common stock. The Company deferred \$5.8 million of the total gain on sale of Jazz Semiconductor due to its on-going investment in Jazz Technologies. This deferred gain is included in accumulated other comprehensive income (loss) on the accompanying condensed consolidated balance sheet at June 29, 2007 and has been partially reduced by a \$4.8 million unrealized holding loss related to the Jazz Technologies shares.

At June 29, 2007 and September 29, 2006, the Company had net payables to Jazz Semiconductor of \$0.7 million and \$7.0 million, respectively.

*Wafer and Probe Services Purchases* During the three months ended June 29, 2007 and June 30, 2006, the Company purchased wafers and probe services from Jazz Semiconductor totaling \$5.7 million and \$11.7 million, respectively. During the nine months ended June 29, 2007 and June 30, 2006, the Company purchased wafers and probe services from Jazz Semiconductor totaling \$19.7 million and \$40.9 million, respectively.

*Lease Agreement* The Company leases a fabrication facility and office space to Jazz Semiconductor. During each of the three months ended June 29, 2007 and June 30, 2006, the Company recorded income related to the Jazz Semiconductor lease agreement of \$0.6 million. During the nine months ended June 29, 2007 and June 30, 2006, the Company recorded income related to the Jazz Semiconductor lease agreement of \$1.7 million and \$2.0 million, respectively.

*Royalty Agreement* The Company has a royalty agreement with Jazz Semiconductor whereby Jazz Semiconductor pays the Company a royalty based on sales of products manufactured using silicon-germanium (SiGe) process technology. During the three and nine months ended June 29, 2007, the Company recorded \$0.6 million and \$2.2 million, respectively, of royalty income from Jazz Semiconductor related to the royalty agreement. There was no royalty income during the three and nine months ended June 30, 2006.

*Services Agreements* The Company had a transition services agreement and information technology services agreement with Jazz Semiconductor to provide certain services to Jazz Semiconductor for a specified period of time subsequent to the formation of Jazz Semiconductor. During the three months ended June 30, 2006, the Company recorded income of \$0.1 million related to the services agreements. During the nine months ended June 29, 2007 and June 30, 2006, the Company recorded income of \$0.1 million and \$0.2 million, respectively, related to the services agreements. These agreements were terminated upon completion of the sale of Jazz Semiconductor in February 2007. No further payments will be received from Jazz Semiconductor pursuant to this agreement.

**Mindspeed Technologies, Inc.**

As of June 29, 2007, the Company holds a warrant to purchase 30 million shares of Mindspeed common stock at an exercise price of \$3.408 per share exercisable through June 2013. In addition, three members of the Company's Board of Directors, including its Chairman, also serve on the Board of Mindspeed. At September 29, 2006, the Company had a net receivable from Mindspeed of \$0.1 million. No significant amounts were due to or receivable from Mindspeed at June 29, 2007.

*Lease Agreement* The Company subleases an office building to Mindspeed. Under the sublease agreement, Mindspeed pays amounts for rental expense and operating expenses, which include utilities, common area maintenance, and security services. During each of the three months ended June 29, 2007 and June 30, 2006, the Company recorded income related to the Mindspeed sublease agreement of \$0.6 million. During each of the nine



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months ended June 29, 2007 and June 30, 2006, the Company recorded income related to the Mindspeed sublease agreement of \$1.8 million. Additionally, Mindspeed made payments directly to the Company's landlord totaling \$1.0 million during each of the three months ended June 29, 2007 and June 30, 2006 and \$3.1 million and \$3.0 million during the nine months ended June 29, 2007 and June 30, 2006, respectively.

**Skyworks Solutions, Inc.**

As of June 29, 2007, the Company holds 6.2 million shares of Skyworks' common stock. In addition, two members of the Company's Board of Directors, including its Chairman, also serve on the Board of Skyworks. At June 29, 2007 and September 29, 2006, the Company had net payables to Skyworks of \$0.3 million and \$0.1 million, respectively. Subsequent to June 29, 2007, the Company sold 2.8 million shares of its Skyworks common stock. See Note 12 Subsequent Events.

*Inventory and Assembly and Test Services Purchases* During the three months ended June 29, 2007 and June 30, 2006, the Company purchased inventory from Skyworks totaling \$0.4 million and \$0.8 million, respectively. During the nine months ended June 29, 2007 and June 30, 2006, the Company purchased inventory from Skyworks totaling \$0.7 million and \$1.5 million, respectively.

*Sublease Rent Share Agreement* The Company had an agreement with Skyworks whereby the Company paid Skyworks two-thirds of the sublease income it received related to certain facilities. During the three months ended June 30, 2006, the Company made payments to Skyworks totaling \$0.1 million. During the nine months ended June 29, 2007 and June 30, 2006, the Company made payments to Skyworks totaling \$0.1 million and \$0.5 million, respectively. The subleases covered by this agreement terminated in October 2006 and the final payment was made to Skyworks in January 2007. No further payments will be made to Skyworks pursuant to this agreement.

**10. Geographic Information**

Net revenues by geographic area, based upon country of destination, were as follows (in thousands):

|                                | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|--------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| United States                  | \$ 8,919                  | \$ 25,872                | \$ 51,469                | \$ 57,974                |
| Other Americas                 | 8,095                     | 6,474                    | 28,906                   | 17,431                   |
| Total Americas                 | 17,014                    | 32,346                   | 80,375                   | 75,405                   |
| China                          | 102,725                   | 127,572                  | 337,380                  | 363,503                  |
| South Korea                    | 14,972                    | 20,593                   | 53,859                   | 76,265                   |
| Taiwan                         | 9,489                     | 13,834                   | 33,578                   | 51,633                   |
| Other Asia-Pacific             | 22,343                    | 34,628                   | 80,043                   | 105,322                  |
| Total Asia-Pacific             | 149,529                   | 196,627                  | 504,860                  | 596,723                  |
| Europe, Middle East and Africa | 13,006                    | 22,662                   | 39,713                   | 52,796                   |
|                                | \$ 179,549                | \$ 251,635               | \$ 624,948               | \$ 724,924               |

The Company believes a portion of the products sold to original equipment manufacturers (OEMs) and third-party manufacturing service providers in the Asia-Pacific region are ultimately shipped to end-markets in the Americas and Europe. In the three months ended June 30, 2006 and the nine months ended June 29, 2007, one distribution customer accounted for 10% of net revenues. No customers accounted for 10% or more of net revenues for the three months

ended June 29, 2007 and the nine months ended June 30, 2006. Sales to the Company's twenty largest customers represented approximately 65% and 68% of net revenues for the three months ended June 29, 2007 and June 30, 2006, respectively, and 69% and 66% of net revenues for the nine months ended June 29, 2007 and June 30, 2006, respectively.

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Long-lived assets consist of property, plant and equipment and certain other long-term assets. Long-lived assets by geographic area were as follows (in thousands):

|                                | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|--------------------------------|--------------------------|-----------------------------------|
| United States                  | \$ 96,058                | \$ 90,095                         |
| India                          | 16,683                   | 10,826                            |
| Other Asia-Pacific             | 9,410                    | 7,117                             |
| Europe, Middle East and Africa | 1,918                    | 2,201                             |
|                                | \$ 124,069               | \$ 110,239                        |

**11. Supplemental Guarantor Financial Information**

In November 2006, the Company issued \$275.0 million of floating rate senior secured notes due November 2010. The floating rate senior secured notes rank equally in right of payment with all of Conexant Systems, Inc.'s (the Parent's) existing and future senior debt and senior to all of its existing and future subordinated debt. The notes are also jointly, severally and unconditionally guaranteed, on a senior basis, by three of the Parent's wholly owned U.S. subsidiaries: Conexant, Inc., Brooktree Broadband Holding, Inc., and Ficon Technology, Inc. (collectively, the Subsidiary Guarantors). The guarantees rank equally in right of payment with all of the Subsidiary Guarantors' existing and future senior debt and senior to all of the Subsidiary Guarantors' existing and future subordinated debt. The notes and guarantees (and certain hedging obligations that may be entered into with respect thereto) are secured by first-priority liens, subject to permitted liens, on substantially all of the Parent's and the Subsidiary Guarantors' assets (other than accounts receivable and proceeds therefrom and subject to certain exceptions), including, but not limited to, the intellectual property, owned real property, plant and equipment now owned or hereafter acquired by the Parent and the Subsidiary Guarantors.

In lieu of providing separate financial statements for the Subsidiary Guarantors, the Company has included the accompanying condensed consolidating financial statements. These condensed consolidating financial statements are presented on the equity method of accounting. Under this method, the Parent's and Subsidiary Guarantors' investments in their subsidiaries are recorded at cost and adjusted for their share of the subsidiaries' cumulative results of operations, capital contributions and distributions and other equity changes. The financial information of the three Subsidiary Guarantors has been combined in the condensed consolidating financial statements.

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
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The following tables present the Company's condensed consolidating balance sheets as of June 29, 2007 and September 29, 2006 (in thousands):

|                                   | <b>June 29, 2007</b> |                   |                       |                     |                     |
|-----------------------------------|----------------------|-------------------|-----------------------|---------------------|---------------------|
|                                   | <b>Parent</b>        | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Current assets:                   |                      |                   |                       |                     |                     |
| Cash and cash equivalents         | \$ 124,809           | \$                | \$ 33,353             | \$                  | \$ 158,162          |
| Marketable securities             | 65,969               |                   |                       |                     | 65,969              |
| Restricted cash                   |                      |                   | 8,800                 |                     | 8,800               |
| Receivables                       | (10,441)             |                   | 105,562               |                     | 95,121              |
| Inventories                       | 63,318               |                   |                       |                     | 63,318              |
| Other current assets              | 15,531               | 2                 | 6,661                 |                     | 22,194              |
| Total current assets              | 259,186              | 2                 | 154,376               |                     | 413,564             |
| Property and equipment, net       | 43,800               |                   | 26,284                |                     | 70,084              |
| Goodwill                          | 68,079               | 481,659           | 30,956                |                     | 580,694             |
| Intangible assets, net            | 6,443                | 32,378            | 2,302                 |                     | 41,123              |
| Other assets                      | 90,649               |                   | 1,945                 |                     | 92,594              |
| Investments in subsidiaries       | 682,388              | 4,839             |                       | (687,227)           |                     |
| Total assets                      | \$ 1,150,545         | \$ 518,878        | \$ 215,863            | \$ (687,227)        | \$ 1,198,059        |
| Current liabilities:              |                      |                   |                       |                     |                     |
| Current portion of long-term debt | \$ 43,900            | \$                | \$                    | \$                  | \$ 43,900           |
| Short-term debt                   |                      |                   | 80,000                |                     | 80,000              |
| Accounts payable                  | 65,324               |                   | 3,326                 |                     | 68,650              |
| Accrued compensation and benefits | 20,927               |                   | 7,745                 |                     | 28,672              |
| Intercompany payable (receivable) | 63,383               | (153,892)         | 90,509                |                     |                     |
| Other current liabilities         | 41,714               | (148)             | 2,457                 |                     | 44,023              |
| Total current liabilities         | 235,248              | (154,040)         | 184,037               |                     | 265,245             |
| Long-term debt                    | 481,100              |                   |                       |                     | 481,100             |
| Other liabilities                 | 65,220               |                   | 1,448                 |                     | 66,668              |
| Total liabilities                 | 781,568              | (154,040)         | 185,485               |                     | 813,013             |
| Shareholders' equity              | 368,977              | 672,918           | 30,378                | (687,227)           | 385,046             |
| Total liabilities and equity      | \$ 1,150,545         | \$ 518,878        | \$ 215,863            | \$ (687,227)        | \$ 1,198,059        |



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|                                   | <b>September 29, 2006</b> |                   |                       |                     |                     |
|-----------------------------------|---------------------------|-------------------|-----------------------|---------------------|---------------------|
|                                   | <b>Parent</b>             | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Current assets:                   |                           |                   |                       |                     |                     |
| Cash and cash equivalents         | \$ 175,398                | \$                | \$ 50,228             | \$                  | \$ 225,626          |
| Marketable securities             | 115,709                   |                   |                       |                     | 115,709             |
| Restricted cash                   |                           |                   | 8,800                 |                     | 8,800               |
| Receivables                       | 19,140                    |                   | 103,885               |                     | 123,025             |
| Inventories                       | 97,460                    |                   |                       |                     | 97,460              |
| Other current assets              | 13,480                    | 3                 | 5,870                 |                     | 19,353              |
| Total current assets              | 421,187                   | 3                 | 168,783               |                     | 589,973             |
| Property and equipment, net       | 45,430                    |                   | 19,975                |                     | 65,405              |
| Goodwill                          | 54,914                    | 616,659           | 39,217                |                     | 710,790             |
| Intangible assets, net            | 6,213                     | 66,751            | 3,044                 |                     | 76,008              |
| Other assets                      | 131,037                   |                   | 412                   |                     | 131,449             |
| Investments in subsidiaries       | 862,726                   | (37,902)          |                       | (824,824)           |                     |
| Total assets                      | \$ 1,521,507              | \$ 645,511        | \$ 231,431            | \$ (824,824)        | \$ 1,573,625        |
| Current liabilities:              |                           |                   |                       |                     |                     |
| Current portion of long-term debt | \$ 188,375                | \$                | \$                    | \$                  | \$ 188,375          |
| Short-term debt                   |                           |                   | 80,000                |                     | 80,000              |
| Accounts payable                  | 111,516                   |                   | 2,174                 |                     | 113,690             |
| Accrued compensation and benefits | 22,824                    |                   | 5,483                 |                     | 28,307              |
| Intercompany payable (receivable) | 50,218                    | (117,590)         | 67,372                |                     |                     |
| Other current liabilities         | 51,109                    |                   | 857                   |                     | 51,966              |
| Total current liabilities         | 424,042                   | (117,590)         | 155,886               |                     | 462,338             |
| Long-term debt                    | 518,125                   |                   |                       |                     | 518,125             |
| Other liabilities                 | 81,823                    |                   | 1,241                 |                     | 83,064              |
| Total liabilities                 | 1,023,990                 | (117,590)         | 157,127               |                     | 1,063,527           |
| Shareholders' equity              | 497,517                   | 763,101           | 74,304                | (824,824)           | 510,098             |
| Total liabilities and equity      | \$ 1,521,507              | \$ 645,511        | \$ 231,431            | \$ (824,824)        | \$ 1,573,625        |



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The following tables present the Company's condensed consolidating statements of operations for the three months ended June 29, 2007 and June 30, 2006 (in thousands):

| <b>Three Months Ended June 29, 2007</b>                                 |               |                   |                       |                     |                     |
|-------------------------------------------------------------------------|---------------|-------------------|-----------------------|---------------------|---------------------|
|                                                                         | <b>Parent</b> | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net revenues                                                            | \$ 148,412    | \$ 6,271          | \$ 31,137             | \$ (6,271)          | \$ 179,549          |
| Cost of goods sold                                                      | 80,097        |                   | 27,677                | (6,271)             | 101,503             |
| Gross margin                                                            | 68,315        | 6,271             | 3,460                 |                     | 78,046              |
| Operating expenses:                                                     |               |                   |                       |                     |                     |
| Research and development                                                | 68,407        |                   | 483                   |                     | 68,890              |
| Selling, general and administrative                                     | 23,113        |                   | 3,121                 |                     | 26,234              |
| Amortization of intangible assets                                       | 718           | 3,861             | 244                   |                     | 4,823               |
| Special charges                                                         | 5,071         |                   |                       |                     | 5,071               |
| Total operating expenses                                                | 97,309        | 3,861             | 3,848                 |                     | 105,018             |
| Operating income (loss)                                                 | (28,994)      | 2,410             | (388)                 |                     | (26,972)            |
| Equity in income (loss) of subsidiaries                                 | 5,759         | 643               |                       | (6,402)             |                     |
| Interest expense                                                        | (9,701)       |                   | (1,648)               |                     | (11,349)            |
| Other income (expense), net                                             | (1,963)       |                   | 5,619                 |                     | 3,656               |
| Income (loss) before income taxes and gain on equity method investments | (34,899)      | 3,053             | 3,583                 | (6,402)             | (34,665)            |
| Provision for income taxes                                              | 507           |                   | 234                   |                     | 741                 |
| Income (loss) before gain on equity method investments                  | (35,406)      | 3,053             | 3,349                 | (6,402)             | (35,406)            |
| Gain on equity method investments                                       | 179           |                   |                       |                     | 179                 |
| Net income (loss)                                                       | \$ (35,227)   | \$ 3,053          | \$ 3,349              | \$ (6,402)          | \$ (35,227)         |

| <b>Three Months Ended June 30, 2006</b> |               |                   |                       |                     |                     |
|-----------------------------------------|---------------|-------------------|-----------------------|---------------------|---------------------|
|                                         | <b>Parent</b> | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net revenues                            | \$ 134,787    | \$ 81,158         | \$ 44,697             | \$ (9,007)          | \$ 251,635          |
| Cost of goods sold                      | 34,026        | 72,121            | 40,458                | (9,007)             | 137,598             |
|                                         | (17,500)      |                   |                       |                     | (17,500)            |

Gain on cancellation of supply  
agreement

|                                                                               |             |             |          |           |             |
|-------------------------------------------------------------------------------|-------------|-------------|----------|-----------|-------------|
| Gross margin                                                                  | 118,261     | 9,037       | 4,239    |           | 131,537     |
| Operating expenses:                                                           |             |             |          |           |             |
| Research and development                                                      | 69,325      | 2           | 769      |           | 70,096      |
| Selling, general and administrative                                           | 25,554      | (1,897)     | 3,380    |           | 27,037      |
| Amortization of intangible assets                                             | 676         | 6,556       | 288      |           | 7,520       |
| Special charges                                                               | 2,610       | 30,000      |          |           | 32,610      |
| Total operating expenses                                                      | 98,165      | 34,661      | 4,437    |           | 137,263     |
| Operating income (loss)                                                       | 20,096      | (25,624)    | (198)    |           | (5,726)     |
| Equity in income (loss) of<br>subsidiaries                                    | (23,743)    | 392         |          | 23,351    |             |
| Interest expense                                                              | (7,986)     | (841)       | (1,599)  |           | (10,426)    |
| Other income (expense), net                                                   | (54,203)    |             | 4,944    |           | (49,259)    |
| Income (loss) before income taxes<br>and loss on equity method<br>investments | (65,836)    | (26,073)    | 3,147    | 23,351    | (65,411)    |
| Provision for income taxes                                                    | 606         |             | 425      |           | 1,031       |
| Income (loss) before loss on equity<br>method investments                     | (66,442)    | (26,073)    | 2,722    | 23,351    | (66,442)    |
| Loss on equity method investments                                             | (648)       |             |          |           | (648)       |
| Net income (loss)                                                             | \$ (67,090) | \$ (26,073) | \$ 2,722 | \$ 23,351 | \$ (67,090) |

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The following tables present the Company's condensed consolidating statements of operations for the nine months ended June 29, 2007 and June 30, 2006 (in thousands):

| <b>Nine Months Ended June 29, 2007</b>                                  |               |                   |                            |                     |                     |
|-------------------------------------------------------------------------|---------------|-------------------|----------------------------|---------------------|---------------------|
|                                                                         | <b>Parent</b> | <b>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net revenues                                                            | \$ 528,234    | \$ 19,374         | \$ 96,714                  | \$ (19,374)         | \$ 624,948          |
| Cost of goods sold                                                      | 277,924       |                   | 89,014                     | (19,374)            | 347,564             |
| Gross margin                                                            | 250,310       | 19,374            | 7,700                      |                     | 277,384             |
| Operating expenses:                                                     |               |                   |                            |                     |                     |
| Research and development                                                | 208,106       |                   | 1,579                      |                     | 209,685             |
| Selling, general and administrative                                     | 70,656        |                   | 9,857                      |                     | 80,513              |
| Amortization of intangible assets                                       | 2,199         | 14,373            | 743                        |                     | 17,315              |
| Special charges                                                         | 13,090        | 155,000           |                            |                     | 168,090             |
| Total operating expenses                                                | 294,051       | 169,373           | 12,179                     |                     | 475,603             |
| Operating loss                                                          | (43,741)      | (149,999)         | (4,479)                    |                     | (198,219)           |
| Equity in income (loss) of subsidiaries                                 | (143,111)     | 1,850             |                            | 141,261             |                     |
| Interest expense                                                        | (32,634)      |                   | (4,971)                    |                     | (37,605)            |
| Other income, net                                                       | 9,880         |                   | 16,497                     |                     | 26,377              |
| Income (loss) before income taxes and gain on equity method investments | (209,606)     | (148,149)         | 7,047                      | 141,261             | (209,447)           |
| Provision for income taxes                                              | 2,285         |                   | 159                        |                     | 2,444               |
| Income (loss) before gain on equity method investments                  | (211,891)     | (148,149)         | 6,888                      | 141,261             | (211,891)           |
| Gain on equity method investments                                       | 44,194        |                   |                            |                     | 44,194              |
| Net income (loss)                                                       | \$ (167,697)  | \$ (148,149)      | \$ 6,888                   | \$ 141,261          | \$ (167,697)        |

| <b>Nine Months Ended June 30, 2006</b> |               |                   |                            |                     |                     |
|----------------------------------------|---------------|-------------------|----------------------------|---------------------|---------------------|
|                                        | <b>Parent</b> | <b>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net revenues                           | \$ 397,078    | \$ 267,905        | \$ 109,639                 | \$ (49,698)         | \$ 724,924          |

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|                                                                         |              |             |          |           |              |
|-------------------------------------------------------------------------|--------------|-------------|----------|-----------|--------------|
| Cost of goods sold                                                      | 116,639      | 219,310     | 100,406  | (27,431)  | 408,924      |
| Gain on cancellation of supply agreement                                | (17,500)     |             |          |           | (17,500)     |
| Gross margin                                                            | 297,939      | 48,595      | 9,233    | (22,267)  | 333,500      |
| Operating expenses:                                                     |              |             |          |           |              |
| Research and development                                                | 197,663      | 18,991      | 2,371    | (19,739)  | 199,286      |
| Selling, general and administrative                                     | 81,505       | 13,424      | 9,557    | (2,528)   | 101,958      |
| Amortization of intangible assets                                       | 2,026        | 20,294      | 865      |           | 23,185       |
| Special charges                                                         | 2,379        | 70,000      |          |           | 72,379       |
| Total operating expenses                                                | 283,573      | 122,709     | 12,793   | (22,267)  | 396,808      |
| Operating income (loss)                                                 | 14,366       | (74,114)    | (3,560)  |           | (63,308)     |
| Equity in income (loss) of subsidiaries                                 | (72,186)     | 1,277       |          | 70,909    |              |
| Interest expense                                                        | (21,582)     | (4,254)     | (3,444)  |           | (29,280)     |
| Other income (expense), net                                             | (16,958)     |             | 13,838   |           | (3,120)      |
| Income (loss) before income taxes and loss on equity method investments | (96,360)     | (77,091)    | 6,834    | 70,909    | (95,708)     |
| Provision for income taxes                                              | 1,830        |             | 652      |           | 2,482        |
| Income (loss) before loss on equity method investments                  | (98,190)     | (77,091)    | 6,182    | 70,909    | (98,190)     |
| Loss on equity method investments                                       | (3,303)      |             |          |           | (3,303)      |
| Net income (loss)                                                       | \$ (101,493) | \$ (77,091) | \$ 6,182 | \$ 70,909 | \$ (101,493) |

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

The following tables present the Company's condensed consolidating statements of cash flows for the nine months ended June 29, 2007 and June 30, 2006 (in thousands):

|                                                             | <b>Nine Months Ended June 29, 2007</b> |                   |                       |                     |                     |
|-------------------------------------------------------------|----------------------------------------|-------------------|-----------------------|---------------------|---------------------|
|                                                             | <b>Parent</b>                          | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net cash (used in) provided by operating activities         | \$ (13,085)                            | \$                | \$ 15,578             | \$ (20,441)         | \$ (17,948)         |
| Cash flows from investing activities:                       |                                        |                   |                       |                     |                     |
| Proceeds from equity securities and other assets            | 105,923                                |                   |                       |                     | 105,923             |
| Proceeds from sales and maturities of marketable securities | 84,819                                 |                   |                       |                     | 84,819              |
| Purchases of marketable securities                          | (26,462)                               |                   |                       |                     | (26,462)            |
| Purchases of property and equipment                         | (12,319)                               |                   | (10,814)              |                     | (23,133)            |
| Payments for acquisitions                                   | (5,029)                                |                   |                       |                     | (5,029)             |
| Purchases of equity securities                              | (600)                                  |                   |                       |                     | (600)               |
| Purchases of accounts receivable                            |                                        |                   | (473,774)             | 473,774             |                     |
| Collections of accounts receivable                          |                                        |                   | 469,028               | (469,028)           |                     |
| Net cash provided by (used in) investing activities         | 146,332                                |                   | (15,560)              | 4,746               | 135,518             |
| Cash flows from financing activities:                       |                                        |                   |                       |                     |                     |
| Proceeds from short-term debt, net                          |                                        |                   | (1,198)               |                     | (1,198)             |
| Proceeds from long-term debt, net                           | 265,012                                |                   |                       |                     | 265,012             |
| Repurchases and retirements of long-term debt               | (456,500)                              |                   |                       |                     | (456,500)           |
| Proceeds from issuance of common stock                      | 7,627                                  |                   |                       |                     | 7,627               |
| Repayment of shareholder notes                              | 25                                     |                   |                       |                     | 25                  |
| Dividends paid                                              |                                        |                   | (15,695)              | 15,695              |                     |
| Net cash used in financing activities                       | (183,836)                              |                   | (16,893)              | 15,695              | (185,034)           |
| Net decrease in cash and cash equivalents                   | (50,589)                               |                   | (16,875)              |                     | (67,464)            |
| Cash and cash equivalents at beginning of period            | 175,398                                |                   | 50,228                |                     | 225,626             |

|                                               |            |    |           |    |            |
|-----------------------------------------------|------------|----|-----------|----|------------|
| Cash and cash equivalents at end<br>of period | \$ 124,809 | \$ | \$ 33,353 | \$ | \$ 158,162 |
|-----------------------------------------------|------------|----|-----------|----|------------|

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**CONEXANT SYSTEMS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

|                                                             | <b>Nine Months Ended June 30, 2006</b> |                   |                       |                     |                     |
|-------------------------------------------------------------|----------------------------------------|-------------------|-----------------------|---------------------|---------------------|
|                                                             | <b>Parent</b>                          | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
| Net cash provided by (used in) operating activities         | \$ 9,994                               | \$                | \$ 8,400              | \$ (72,657)         | \$ (54,263)         |
| Cash flows from investing activities:                       |                                        |                   |                       |                     |                     |
| Proceeds from equity securities and other assets            | 5,200                                  |                   |                       |                     | 5,200               |
| Proceeds from sales and maturities of marketable securities | 89,862                                 |                   |                       |                     | 89,862              |
| Purchases of marketable securities                          | (62,796)                               |                   |                       |                     | (62,796)            |
| Purchases of property and equipment                         | (13,222)                               |                   | (10,278)              |                     | (23,500)            |
| Payments for acquisitions                                   | (6,900)                                |                   |                       |                     | (6,900)             |
| Purchases of equity securities                              | (705)                                  |                   |                       |                     | (705)               |
| Restricted cash                                             |                                        |                   | (8,800)               |                     | (8,800)             |
| Purchases of accounts receivable                            |                                        |                   | (416,368)             | 416,368             |                     |
| Collections of accounts receivable                          |                                        |                   | 343,711               | (343,711)           |                     |
| Net cash provided by (used in) investing activities         | 11,439                                 |                   | (91,735)              | 72,657              | (7,639)             |
| Cash flows from financing activities:                       |                                        |                   |                       |                     |                     |
| Proceeds from short-term debt, net                          |                                        |                   | 78,459                |                     | 78,459              |
| Proceeds from long-term debt, net                           | 243,609                                |                   |                       |                     | 243,609             |
| Repurchases and retirements of long-term debt               | (254,684)                              |                   |                       |                     | (254,684)           |
| Proceeds from issuance of common stock                      | 17,112                                 |                   |                       |                     | 17,112              |
| Repayment of shareholder notes                              | 163                                    |                   |                       |                     | 163                 |
| Net cash provided by financing activities                   | 6,200                                  |                   | 78,459                |                     | 84,659              |
| Net increase (decrease) in cash and cash equivalents        | 27,633                                 |                   | (4,876)               |                     | 22,757              |
| Cash and cash equivalents at beginning of period            | 170,793                                |                   | 31,911                |                     | 202,704             |
|                                                             | \$ 198,426                             | \$                | \$ 27,035             | \$                  | \$ 225,461          |

Cash and cash equivalents at end  
of period

## 12. Subsequent Events

On July 9, 2007, under the terms of the employment agreement with the Company's new President and Chief Executive Officer, the Company granted 1,500,000 shares of restricted stock with a three year vesting period (833,333 on the first anniversary of the grant date and 333,333 on the second and third anniversaries), 3,000,000 stock options with an exercise price of \$1.53 and a three year vesting period and 1,000,000 stock performance awards the vesting of which is dependent upon satisfying performance measures through July 2012. The performance restricted stock units will vest at a rate of one-third if the Company's common stock sustains an average closing price of \$3.00 over a 60 calendar day period, one-third if the Company's common stock sustains an average closing price of \$4.50 over a 60 calendar day period and one-third if the Company's common stock sustains an average closing price of \$6.00 over a 60 calendar day period. Any unvested portion of the performance restricted stock units will be forfeited five years after grant. In the event of a change of control of the Company (as defined in the employment agreement), the stock options and non-performance based restricted stock units described above that are not vested will vest and, if not already vested, one-third of the performance restricted stock units described above will vest if the closing price of the Company's common stock is at or above the vesting thresholds outlined above.

From July 24, 2007 to August 3, 2007, the Company sold 2.8 million shares of its Skyworks common stock at an average price of \$8.20 per share, for net proceeds of \$22.6 million. The sales will result in a recognized gain of \$7.4 million in the fourth quarter of fiscal 2007.

On August 2, 2007, the Company received \$7.3 million as settlement for escrow amounts related to the sale of Jazz Technologies in February 2007. The settlement will result in recognizing an additional gain on the sale of Jazz Technologies of approximately \$400,000 in the fourth quarter of 2007.

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

The following discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 and the Risk Factors included in Part II, Item 1A of this Quarterly Report, as well as other cautionary statements and risks described elsewhere in this Quarterly Report, and our audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended September 29, 2006.

**Overview**

We design, develop and sell semiconductor system solutions, comprised of semiconductor devices, software and reference designs, for use in broadband communications applications that enable high-speed transmission, processing and distribution of audio, video, voice and data to and throughout homes and business enterprises worldwide. Our access solutions connect people through personal communications access products, such as personal computers (PCs) and television set-top boxes (STBs), to audio, video, voice and data services over wireless and wire line broadband connections as well as over dial-up Internet connections. Our central office solutions are used by service providers to deliver high-speed audio, video, voice and data services over copper telephone lines and optical fiber networks to homes and businesses around the globe. In addition, our media processing products enable the capture, display, storage, playback and transfer of audio and video content in applications throughout home and small office environments. These solutions enable broadband connections and network content to be shared throughout a home or small office-home office environment using a variety of communications devices, which we describe as the broadband digital home.

We market and sell our semiconductor products and system solutions directly to leading original equipment manufacturers (OEMs) of communication electronics products, and indirectly through electronic components distributors. We also sell our products to third-party electronic manufacturing service providers, who manufacture products incorporating our semiconductor products for OEMs. Sales to distributors and other resellers accounted for approximately 33% of our net revenues in the nine months ended June 29, 2007, compared to 35% of our net revenues in the nine months ended June 30, 2006. One distribution customer accounted for 10% of net revenues for the three months ended June 30, 2006 and the nine months ended June 29, 2007. No customers accounted for 10% or more of net revenues for the three months ended June 29, 2007 and the nine months ended June 30, 2006. Our top 20 customers accounted for approximately 65% and 68% of net revenues for the three months ended June 29, 2007 and June 30, 2006, respectively, and 69% and 66% of net revenues for the nine months ended June 29, 2007 and June 30, 2006, respectively. Revenues derived from customers located in the Americas, the Asia-Pacific region and Europe (including the Middle East and Africa) were 13%, 81% and 6%, respectively, of our net revenues for the nine months ended June 29, 2007 and were 11%, 82% and 7%, respectively, of our net revenues for the nine months ended June 30, 2006. We believe a portion of the products we sell to OEMs and third-party manufacturing service providers in the Asia-Pacific region are ultimately shipped to end-markets in the Americas and Europe.

**Business Enterprise Segments**

We operate in one reportable segment, broadband communications. Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for the way that public business enterprises report information about operating segments in consolidated financial statements. Although we had four operating segments at June 29, 2007, under the aggregation criteria set forth in SFAS No. 131, we only operate in one reportable segment, broadband communications.

Under SFAS No. 131, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles of SFAS No. 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas:

the nature of products and services;

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the nature of the production processes;

the type or class of customer for their products and services; and

the methods used to distribute their products or provide their services.

We meet each of the aggregation criteria for the following reasons:

the sale of semiconductor products is the only material source of revenue for each of our four operating segments;

the products sold by each of our operating segments use the same standard manufacturing process;

the products marketed by each of our operating segments are sold to similar customers; and

all of our products are sold through our internal sales force and common distributors.

Because we meet each of the criteria set forth above and each of our operating segments has similar economic characteristics, we aggregate our results of operations in one reportable segment.

**Results of Operations*****Net Revenues***

|                       | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|-----------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                       | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| <i>(in thousands)</i> |                           |                          |                          |                          |
| Net revenues          | \$ 179,549                | \$ 251,635               | \$ 624,948               | \$ 724,924               |

We recognize revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the sales price and terms are fixed and determinable, and (iv) the collection of the receivable is reasonably assured. These terms are typically met upon shipment of product to the customer, except for certain distributors who have unlimited contractual rights of return or for whom the contractual terms were not enforced, or when significant vendor obligations exist. Revenue with respect to sales to distributors with unlimited rights of return or for whom contractual terms were not enforced is deferred until the purchased products are sold by the distributors to third parties. At June 29, 2007 and September 29, 2006, deferred revenue related to sales to these distributors was \$6.9 million and \$6.7 million, respectively. Revenue with respect to sales to customers to whom we have significant obligations after delivery is deferred until all significant obligations have been completed. At June 29, 2007 and September 29, 2006, deferred revenue related to shipments of products for which we have on-going performance obligations was \$3.0 million and \$6.6 million, respectively. The majority of our distributors have limited stock rotation rights, which allow them to rotate up to 10% of product in their inventory two times a year. We recognize revenue to these distributors upon shipment of product to the distributor, as the stock rotation rights are limited and we believe that we have the ability to reasonably estimate and establish allowances for expected product returns in accordance with SFAS No. 48, Revenue Recognition When Right of Return Exists. Development revenue is recognized when services are performed and was not significant for any periods presented.

Our net revenues decreased 29% during the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006. This decrease was driven by a 22% decrease in average selling prices (ASPs) and an 8% decrease in unit volume shipments. In the third quarter of fiscal 2007, we experienced revenue decreases in a majority of our product lines. Additionally, a program in the cable set-top box product line of our Broadband Media Processing business was terminated in the second quarter of fiscal 2007. The program that these cable set-top box products were related to ended as a result of regulatory requirements.

Our net revenues decreased 14% during the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006. This decrease was primarily driven by an 11% decrease in ASPs and, to a lesser extent, a 3% decrease in unit volume shipments. In the first nine months of fiscal 2007, we experienced revenue decreases in a majority of our product lines, with the exception of our Broadband Media Processing products which experienced a \$47.6 million

increase in net revenues resulting from a cable set-top box program and a full system solution satellite set-top box product ramping into production in the latter part of calendar 2006.

In the fourth quarter of fiscal 2007, we expect net revenues to approximate the level reported in the third quarter of fiscal 2007.

**Table of Contents*****Gross Margin***

| <i>(in thousands)</i>   | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|-------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                         | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| Gross margin            | \$78,046                  | \$131,537                | \$277,384                | \$333,500                |
| Percent of net revenues | 43%                       | 52%                      | 44%                      | 46%                      |

Gross margin represents net revenues less cost of goods sold. As a fabless semiconductor company, we use third parties for wafer production and assembly and test services. Our cost of goods sold consists predominantly of purchased finished wafers, assembly and test services, royalties, amortization of production photo mask costs, other intellectual property costs, labor and overhead associated with product procurement, and non-cash stock-based compensation charges for procurement personnel.

Our gross margin percentage for the third quarters of fiscal 2007 and 2006 was 43% and 52%, respectively, and for the first nine months of fiscal 2007 and 2006 was 44% and 46%, respectively. During the third quarter of fiscal 2006, we recorded a \$17.5 million gain related to the cancellation of a wafer supply and services agreement with Jazz Semiconductor, which was recorded as a reduction of cost of sales. Excluding this gain in the third quarter of fiscal 2006, the impact of changes to our inventory reserves and the impact of changes to revenue reserves that we maintain to estimate customer pricing adjustments in the third quarter and first nine months of fiscal 2007 and 2006, our gross margin percentage would have been 44% for the third quarter of fiscal 2006 and 43% for the first nine months of fiscal 2006. Our gross margin percentage was unaffected by these changes for the third quarter and first nine months of fiscal 2007. Excluding the gain in the third quarter of fiscal 2006 and the changes to our inventory reserves mentioned above, the gross margin percentage in the third quarter and first nine months of fiscal 2007 and fiscal 2006 remained relatively stable because manufacturing cost reductions offset the 22% and 11% reductions in ASPs for the third quarter and first nine months of fiscal 2007, respectively.

We assess the recoverability of our inventories on a quarterly basis through a review of inventory levels in relation to foreseeable demand, generally over the following twelve months. Foreseeable demand is based upon available information, including sales backlog and forecasts, product marketing plans and product life cycle information. When the inventory on hand exceeds the foreseeable demand, we write down the value of those inventories which, at the time of our review, we expect to be unable to sell. The amount of the inventory write-down is the excess of historical cost over estimated realizable value. Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand is lower than originally projected, additional inventory write-downs may be required. Similarly, in the event that actual demand exceeds original projections, gross margins may be favorably impacted in future periods. During the three months ended June 29, 2007 and June 30, 2006, we recorded \$2.1 million and \$4.9 million, respectively, in inventory charges for excess and obsolete (E&O) inventory. During the nine months ended June 29, 2007 and June 30, 2006, we recorded \$5.9 million and \$12.1 million, respectively, in inventory charges for E&O inventory. Activity in our E&O inventory reserves for the three and nine months ended June 29, 2007 and June 30, 2006 was as follows:

| <i>(in thousands)</i>             | <b>Three Months Ended</b>    |                          | <b>Nine Months Ended</b> |                          |
|-----------------------------------|------------------------------|--------------------------|--------------------------|--------------------------|
|                                   | <b>June<br/>29,<br/>2007</b> | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| E&O reserves, beginning of period | \$ 26,631                    | \$ 39,793                | \$ 36,632                | \$ 44,833                |
| Additions                         | 2,112                        | 4,949                    | 5,873                    | 12,123                   |
| Release upon sales of product     | (2,739)                      | (2,175)                  | (8,871)                  | (8,826)                  |
| Scrap                             | (4,332)                      | (2,503)                  | (10,350)                 | (5,345)                  |
| Standards adjustments and other   | 564                          | (1,168)                  | (1,048)                  | (3,889)                  |

|                             |           |           |           |           |
|-----------------------------|-----------|-----------|-----------|-----------|
| E&O reserves, end of period | \$ 22,236 | \$ 38,896 | \$ 22,236 | \$ 38,896 |
|-----------------------------|-----------|-----------|-----------|-----------|

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We review our E&O inventory balances at the product line level on a quarterly basis. We plan to scrap approximately 20% of the E&O inventory balances which existed as of June 29, 2007, and regularly evaluate the disposition of all E&O inventory products. It is possible that some of these reserved products will be sold which will benefit our gross margin in the period sold. During the three months ended June 29, 2007 and June 30, 2006, we sold \$2.7 million and \$2.2 million, respectively, of reserved products, and during the nine months ended June 29, 2007 and June 30, 2006, we sold \$8.9 million and \$8.8 million, respectively, of reserved products.

Our products are used by communications electronics OEMs that have designed our products into communications equipment. For many of our products, we gain these design wins through a lengthy sales cycle, which often includes providing technical support to the OEM customer. Moreover, once a customer has designed a particular supplier's components into a product, substituting another supplier's components often requires substantial design changes which involve significant cost, time, effort and risk. In the event of the loss of business from existing OEM customers, we may be unable to secure new customers for our existing products without first achieving new design wins. When the quantities of inventory on hand exceed foreseeable demand from existing OEM customers into whose products our products have been designed, we generally will be unable to sell our excess inventories to others, and the estimated realizable value of such inventories to us is generally zero.

On a quarterly basis, we also assess the net realizable value of our inventories. When the estimated ASP, plus costs to sell our inventory, falls below our inventory cost, we adjust our inventory to its current estimated market value.

During the three months ended June 30, 2006, we recorded \$0.3 million of inventory charges to reduce certain products to their estimated market value. During the nine months ended June 29, 2007 and June 30, 2006, we recorded \$0.5 million and \$3.6 million, respectively, of inventory charges to reduce certain products to their estimated market value. There were no inventory charges recorded during the three months ended June 29, 2007. Increases to the lower of cost or market (LCM) inventory reserves may be required based upon actual ASPs and changes to our current estimates, which would impact our gross margin percentage in future periods. Activity in our LCM inventory reserves for the three and nine months ended June 29, 2007 and June 30, 2006 was as follows:

|                                   | Three Months Ended |               | Nine Months Ended |               |
|-----------------------------------|--------------------|---------------|-------------------|---------------|
|                                   | June 29, 2007      | June 30, 2006 | June 29, 2007     | June 30, 2006 |
| <i>(in thousands)</i>             |                    |               |                   |               |
| LCM reserves, beginning of period | \$ 653             | \$ 6,228      | \$ 1,761          | \$ 6,739      |
| Additions                         |                    | 288           | 467               | 3,609         |
| Release upon sales of product     | (320)              | (1,526)       | (1,672)           | (5,312)       |
| Standards adjustments and other   |                    |               | (223)             | (46)          |
| LCM reserves, end of period       | \$ 333             | \$ 4,990      | \$ 333            | \$ 4,990      |

**Research and Development**

|                          | Three Months Ended |               | Nine Months Ended |               |
|--------------------------|--------------------|---------------|-------------------|---------------|
|                          | June 29, 2007      | June 30, 2006 | June 29, 2007     | June 30, 2006 |
| <i>(in thousands)</i>    |                    |               |                   |               |
| Research and development | \$68,890           | \$70,096      | \$209,685         | \$199,286     |
| Percent of net revenues  | 38%                | 28%           | 34%               | 27%           |

Our research and development (R&D) expenses consist principally of direct personnel costs to develop new semiconductor products, allocated indirect costs of the R&D function, photo mask and other costs for pre-production evaluation and testing of new devices and design and test tool costs. Our R&D expenses also include the costs for design automation advanced package development and non-cash stock-based compensation charges for R&D personnel.

R&D expense decreased \$1.2 million in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 primarily due to a \$3.5 million decrease in stock-based compensation expense, partially offset by a \$0.9 million increase in depreciation expense due to our expansion in the Asia Pacific region and \$0.9 million of credits related to property tax settlements that were recorded in the third quarter of fiscal 2006. The decrease in stock-based compensation expense was primarily due to declines in the expense related to the options assumed in the merger

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with GlobspanVirata, Inc. as the options become fully vested and declines in the expense related to the options granted in June 2005, which vest over three years and are being amortized to expense using the accelerated method described in FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans. The options granted in June 2005 were issued pursuant to an offer made to employees in November 2004 to exchange certain outstanding stock options.

R&D expense increased \$10.4 million during the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 primarily due to increased product development costs, a \$2.9 million increase in depreciation expense due to our expansion in the Asia Pacific region, and \$4.3 million of credits related to property tax settlements that were recorded in the first nine months of fiscal 2006. These increases were partially offset by a \$9.6 million decrease in stock-based compensation expense.

***Selling, General and Administrative***

|                                     | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|-------------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                     | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| <i>(in thousands)</i>               |                           |                          |                          |                          |
| Selling, general and administrative | \$26,234                  | \$27,037                 | \$80,513                 | \$101,958                |
| Percent of net revenues             | 15%                       | 11%                      | 13%                      | 14%                      |

Our selling, general and administrative (SG&A) expenses include personnel costs, sales representative commissions, advertising and other marketing costs. Our SG&A expenses also include costs of corporate functions including legal, accounting, treasury, human resources, customer service, sales, marketing, field application engineering, allocated indirect costs of the SG&A function, and non-cash stock-based compensation charges for SG&A personnel.

SG&A expense decreased \$0.8 million in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006. This decrease is primarily attributable to a \$2.6 million decrease in payroll expense as a result of our restructuring efforts and a \$1.6 million decrease in stock-based compensation expense. These decreases were partially offset by a \$2.2 million increase in legal expense mainly due to a \$1.9 million net credit recorded in the third quarter of fiscal 2006 that resulted when we settled our litigation with Texas Instruments in the third quarter of fiscal 2006 and \$0.9 million of credits related to property tax settlements that were recorded in the third quarter of fiscal 2006. The decrease in stock-based compensation expense was primarily due to declines in the expense related to the options assumed in the merger with GlobspanVirata, Inc. as the options become fully vested, and declines in the expense related to the options granted in June 2005, which vest over three years and are being amortized to expense using the accelerated method described in FASB Interpretation No. 28. The options granted in June 2005 were issued pursuant to an offer made to employees in November 2004 to exchange certain outstanding stock options.

SG&A expense decreased \$21.4 million during the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006. This decrease is primarily attributable to a \$13.3 million decrease in stock-based compensation expense, a \$10.5 million decrease in legal expense primarily due to the settlement of our litigation with Texas Instruments in the third quarter of fiscal 2006 and a \$4.5 million decrease in payroll expense as a result of our restructuring efforts. These decreases were partially offset by \$4.0 million of credits related to property tax settlements that were recorded in the first nine months of fiscal 2006.

***Amortization of Intangible Assets***

|                                   | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|-----------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                   | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| <i>(in thousands)</i>             |                           |                          |                          |                          |
| Amortization of intangible assets | \$4,823                   | \$7,520                  | \$17,315                 | \$23,185                 |

Amortization of intangible assets consists of amortization expense for intangible assets acquired in various business combinations. Our intangible assets are being amortized over a weighted-average period of approximately six years.

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Amortization expense decreased \$2.7 million in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 and decreased \$5.9 million during the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006. These decreases were due to the \$20.0 million impairment charge and write-down of certain intangible assets in the second quarter of fiscal 2007, the modification of the useful lives of some of the intangible assets acquired in the merger with GlobespanVirata, Inc. and some intangible assets becoming fully amortized during fiscal 2006.

**Special Charges**

|                                 | Three Months Ended |               | Nine Months Ended |               |
|---------------------------------|--------------------|---------------|-------------------|---------------|
|                                 | June 29, 2007      | June 30, 2006 | June 29, 2007     | June 30, 2006 |
| <i>(in thousands)</i>           |                    |               |                   |               |
| Asset impairments               | \$ 3,415           | \$            | \$ 158,415        | \$ 85         |
| Restructuring charges           | 1,656              | 2,610         | 8,053             | 2,394         |
| Litigation charges              |                    | 30,000        |                   | 70,000        |
| Other special charges (credits) |                    |               | 1,622             | (100)         |
|                                 | \$ 5,071           | \$ 32,610     | \$ 168,090        | \$ 72,379     |

Special charges for the third quarter of fiscal 2007 consist of a \$3.4 million impairment charge for the early termination of an IP license agreement and \$1.7 million of restructuring charges. Special charges for the first nine months of fiscal 2007 consist of \$158.4 million of impairment charges, including a \$135.0 million impairment charge related to goodwill, a \$20.0 million impairment charge for intangible assets and a \$3.4 million impairment charge for the early termination of an IP license agreement. The goodwill and intangible asset impairment charges resulted from a reduced revenue forecast for wireless products targeted at the embedded cellular handset market. Special charges for the first nine months of fiscal 2007 also included restructuring charges of \$8.1 million and other special charges of \$1.6 million. The restructuring charges for the third quarter and the first nine months of fiscal 2007 were primarily comprised of employee severance and termination benefit costs related to our fiscal 2007 restructuring actions and, to a lesser extent, facilities related charges mainly resulting from the accretion of rent expense related to our fiscal 2005 restructuring action.

Special charges for the third quarter of fiscal 2006 consisted of a \$30.0 million charge related to our litigation with Texas Instruments, which was settled in the third quarter of fiscal 2006 for \$70.0 million and \$2.6 million of restructuring charges mainly related to our fiscal 2006 restructuring action. Special charges for the first nine months of fiscal 2006 consisted of a \$70.0 million charge related to our litigation with Texas Instruments and \$2.4 million of restructuring charges. The restructuring charges were comprised of \$3.4 million for employee severance and other termination benefit costs, \$0.4 million of facilities closure costs related to our fiscal 2006 restructuring action and \$1.0 million of facilities related charges resulting from the accretion of rent expense related to our fiscal 2005 restructuring action, partially offset by a \$2.5 million net reduction of the accrual relating to our fiscal 2005 restructuring action due to a revised estimate of the remaining employee severance and termination benefit costs to be paid.

**Interest Expense**

|                       | Three Months Ended |               | Nine Months Ended |               |
|-----------------------|--------------------|---------------|-------------------|---------------|
|                       | June 29, 2007      | June 30, 2006 | June 29, 2007     | June 30, 2006 |
| <i>(in thousands)</i> |                    |               |                   |               |
| Interest expense      | \$ 11,349          | \$ 10,426     | \$ 37,605         | \$ 29,280     |

Interest expense increased \$0.9 million in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 and \$8.3 million during the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006. These increases are attributable to the issuance of \$275.0 million aggregate principal amount of floating rate senior secured notes in November 2006, the issuance of \$250.0 million aggregate principal amount of 4.00% convertible

subordinated notes in March 2006 and May 2006 and the \$80.0 million short-term credit facility we established in November 2005. The increases in interest expense resulting from these debt issuances were substantially offset by the retirement of \$456.5 million aggregate principal amount of 4.00% convertible subordinated notes due February 2007 and the retirement of \$130.0 million aggregate principal amount of 5.25% convertible subordinated notes and

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the \$66.8 million aggregate principal amount of 4.25% convertible subordinated notes due May 2006. The average interest rate that we pay on our outstanding debt has increased during the third quarter and first nine months of fiscal 2007 compared with the same periods in fiscal 2006, and due to the timing of these issuances and retirements, our average debt balances during the first nine months of fiscal 2007 were higher than the first nine months of fiscal 2006.

***Other Income (Expense), Net***

|                                                             | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                 |
|-------------------------------------------------------------|---------------------------|-----------------|--------------------------|-----------------|
|                                                             | <b>June</b>               |                 | <b>June</b>              |                 |
| <b>(in thousands)</b>                                       | <b>29,</b>                | <b>June 30,</b> | <b>29,</b>               | <b>June 30,</b> |
|                                                             | <b>2007</b>               | <b>2006</b>     | <b>2007</b>              | <b>2006</b>     |
| Investment and interest income                              | \$ 2,110                  | \$ 4,518        | \$ 11,299                | \$ 14,415       |
| Increase (decrease) in fair value of derivative instruments | 944                       | (35,131)        | 7,868                    | (3,800)         |
| Impairment of equity securities                             |                           | (18,456)        |                          | (18,456)        |
| Gains on investments in equity securities                   | 101                       |                 | 6,570                    | 4,414           |
| Other                                                       | 501                       | (190)           | 640                      | 307             |
|                                                             | \$ 3,656                  | \$ (49,259)     | \$ 26,377                | \$ (3,120)      |

Other income (expense), net during the third quarter of fiscal 2007 was primarily comprised of \$2.1 million of investment and interest income on invested cash balances and a \$0.9 million increase in the fair value of our warrant to purchase 30 million shares of Mindspeed common stock mainly due to an increase in Mindspeed's stock price during the period. Other income (expense), net during the first nine months of fiscal 2007 was primarily comprised of \$11.3 million of investment and interest income on invested cash balances, a \$7.9 million increase in the fair value of the Mindspeed warrant, and \$6.6 million of gains on investments in equity securities.

Other income (expense), net for the third quarter of fiscal 2006 was primarily comprised of a \$35.1 million decrease in the fair value of our warrant to purchase 30 million shares of Mindspeed common stock mainly due to a decrease in Mindspeed's stock price during the period, and an \$18.5 million charge for the impairment of our Skyworks shares, partially offset by \$4.5 million of investment and interest income on invested cash balances. Other income (expense), net for the first nine months of fiscal 2006 was primarily comprised of an \$18.5 million charge for the impairment of our Skyworks shares and a \$3.8 million decrease in the fair value of the Mindspeed warrant, partially offset by \$14.4 million of investment and interest income on invested cash balances and \$4.4 million of gains on sales of equity securities.

***Provision for Income Taxes***

We recorded income tax expense of \$0.7 million and \$1.0 million in the third quarters of fiscal 2007 and 2006, respectively, and \$2.4 million and \$2.5 million for the first nine months of fiscal 2007 and 2006, respectively, primarily reflecting income taxes imposed on our foreign subsidiaries. All of our U.S. Federal income taxes and the majority of our state income taxes are offset by fully reserved deferred tax assets.

As of June 29, 2007, we had approximately \$1.3 billion of net deferred income tax assets, which are primarily related to U.S. Federal income tax net operating loss (NOL) carryforwards and capitalized R&D expenses and which can be used to offset taxable income in subsequent years. Approximately \$753.0 million of the NOL carryforwards were acquired in business combinations, and if we receive a tax benefit from their utilization, the benefit will be recorded as a reduction to goodwill. The deferred tax assets acquired in the merger with GlobespanVirata are subject to limitations imposed by section 382 of the Internal Revenue Code. Such limitations are not expected to impair our ability to utilize these deferred tax assets. As of June 29, 2007, we have a valuation allowance recorded against the majority of our deferred tax assets, resulting in net deferred tax assets of \$0.7 million. We do not expect to recognize any domestic income tax benefits relating to future operating losses until we believe that such tax benefits are more likely than not to be realized.

We are subject to income taxes in both the United States and numerous foreign jurisdictions and have also acquired and divested certain businesses for which we have retained certain tax liabilities. In the ordinary course of our business, there are many transactions and calculations in which the ultimate tax determination is uncertain and

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significant judgment is required in determining our worldwide provision for income taxes. We and our acquired and divested businesses are regularly under audit by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits could be different than that which is reflected in historical income tax provisions and accruals. Based on the results of an audit, a material effect on our income tax provision, net income, or cash flows in the period or periods for which that determination is made could result.

***Gain (Loss) on Equity Method Investments***

|                                          | <b>Three Months Ended</b> |                          | <b>Nine Months Ended</b> |                          |
|------------------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                          | <b>June 29,<br/>2007</b>  | <b>June 30,<br/>2006</b> | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| <i>(in thousands)</i>                    |                           |                          |                          |                          |
| Gain (loss) on equity method Investments | \$ 179                    | \$(648)                  | \$44,194                 | \$(3,303)                |

Gain (loss) on equity method investments includes our share of the earnings or losses of the investments that are recorded under the equity method of accounting, as well as the gains and losses recognized on the sale of our equity method investments. During the nine months ended June 29, 2007, we recorded a \$43.5 million gain on the sale of one of our equity method investments, Jazz Semiconductor, to Acquicor Technology Inc. (now Jazz Technologies, Inc.). We have also recorded a deferred gain of \$5.8 million as a result of our on-going investment in Jazz Technologies.

***Liquidity and Capital Resources***

Our principal sources of liquidity are our cash, cash equivalents and marketable securities. Total cash, cash equivalents and marketable securities were as follows:

|                                                                                                                    | <b>June 29,<br/>2007</b> | <b>September<br/>29,<br/>2006</b> |
|--------------------------------------------------------------------------------------------------------------------|--------------------------|-----------------------------------|
| <i>(in thousands)</i>                                                                                              |                          |                                   |
| Cash and cash equivalents                                                                                          | \$ 158,162               | \$ 225,626                        |
| Marketable debt securities                                                                                         | 15,361                   | 83,620                            |
| Subtotal                                                                                                           | 173,523                  | 309,246                           |
| Marketable equity securities Skyworks Solutions, Inc. (6.2 million shares at June 29, 2007 and September 29, 2006) | 45,444                   | 32,089                            |
| Marketable equity securities Jazz Technologies, Inc. (1.7 million shares at June 29, 2007)                         | 5,164                    |                                   |
| Subtotal                                                                                                           | 50,608                   | 32,089                            |
| Total cash, cash equivalents and marketable securities                                                             | \$ 224,131               | \$ 341,335                        |

Our cash, cash equivalents and marketable securities decreased \$117.2 million between September 29, 2006 and June 29, 2007. The decrease was primarily due to the retirement of the remaining \$456.5 million principal amount of our 4.00% convertible subordinated notes at maturity in February 2007, capital expenditures of \$23.1 million, and cash used in operating activities of \$17.9 million, which were partially offset by net proceeds of \$265.0 million received upon issuance of our floating rate senior secured notes in November 2006 and \$98.1 million of proceeds received for the sale of our investment in Jazz Semiconductor in February 2007.

At June 29, 2007, our cash, cash equivalents and marketable securities include 6.2 million shares of Skyworks common stock valued at \$45.4 million and 1.7 million shares of Jazz Technologies common stock valued at \$5.2 million. For these securities, there is risk associated with the overall state of the stock market, having available buyers for the shares we may want to sell, and ultimately being able to liquidate the securities at a favorable price in a short period of time. There can be no assurance that the carrying value of these securities will ultimately be realized. From July 24, 2007 to August 3, 2007, we sold 2.8 million shares of our Skyworks common stock at an average price

of \$8.20 per share, for net proceeds of \$22.6 million.

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We also have other assets, including real estate in Newport Beach, California and a warrant to purchase 30 million shares of Mindspeed common stock. The value of the Mindspeed warrant of \$24.3 million is reflected as a long-term asset on our condensed consolidated balance sheet as of June 29, 2007. The valuation of this derivative instrument is subjective, and at any point in time could ultimately result in the realization of amounts significantly different than the carrying value. Further, there is no assurance that the equity markets would allow us to liquidate a substantial portion of this warrant within a short time period without significantly impacting the market value of Mindspeed's common stock and the warrant.

At June 29, 2007, we had a total of \$250.0 million aggregate principal amount of convertible subordinated notes outstanding. These notes are due in March 2026, but the holders may require us to repurchase, for cash, all or part of their notes on March 1, 2011, March 1, 2016 and March 1, 2021 at a price of 100% of the principal amount, plus any accrued and unpaid interest.

At June 29, 2007, we also had a total of \$275.0 million aggregate principal amount of floating rate senior secured notes outstanding. These notes are due in November 2010, but we are required to offer to repurchase, for cash, notes at a price of 100% of the principal amount, plus any accrued and unpaid interest, with the net proceeds of certain asset dispositions if such proceeds are not used within 360 days to invest in assets (other than current assets) related to our business. The sale of our investment in Jazz Semiconductor in February 2007 and the sale of two other equity investments in January 2007 qualify as asset dispositions requiring us to make offers to repurchase a portion of the notes no later than 361 days following the respective asset dispositions. Based on the proceeds received from these asset dispositions and our estimates of cash investments in assets (other than current assets) related to our business to be made within 360 days following the asset dispositions, we estimate that we will be required to make offers to repurchase approximately \$43.9 million of the senior secured notes, at 100% of the principal amount plus any accrued and unpaid interest, in the second quarter of fiscal 2008.

We also have an \$80.0 million credit facility with a bank, under which we had borrowed \$80.0 million as of June 29, 2007. The term of this credit facility has been extended through November 28, 2007, and the facility remains subject to additional 364-day extensions at the discretion of the bank.

We believe that our existing sources of liquidity, together with cash expected to be generated from product sales, will be sufficient to fund our operations, research and development, anticipated capital expenditures and working capital for at least the next twelve months.

Cash flows were as follows:

|                                                      | <b>Nine Months Ended</b> |                          |
|------------------------------------------------------|--------------------------|--------------------------|
|                                                      | <b>June 29,<br/>2007</b> | <b>June 30,<br/>2006</b> |
| <i>(in thousands)</i>                                |                          |                          |
| Net cash used in operating activities                | \$ (17,948)              | \$ (54,263)              |
| Net cash provided by (used in) investing activities  | 135,518                  | (7,639)                  |
| Net cash (used in) provided by financing activities  | (185,034)                | 84,659                   |
| Net (decrease) increase in cash and cash equivalents | \$ (67,464)              | \$ 22,757                |

Cash used in operating activities was \$17.9 million and \$54.3 million for the first nine months of fiscal 2007 and 2006, respectively. During the first nine months of fiscal 2007, we used \$24.3 million of cash from operations and made payments totaling \$17.0 million for restructuring related items. These cash outflows were partially offset by \$23.4 million of net favorable changes in our working capital (accounts receivable, inventories and accounts payable). The favorable changes in working capital were driven by (i) improved days sales outstanding (DSO) primarily the result of increased cash collections, from 46 days in the nine month period ended September 29, 2006 to 42 days in the first nine months of fiscal 2007 and (ii) improved inventory turns from 5.6 turns in the nine month period ended September 29, 2006 to 7.3 turns in the first nine months of fiscal 2007. These favorable changes in working capital were partly offset by a decrease in accounts payable due to the timing of payments.

In the first nine months of fiscal 2006, we generated \$57.3 million of cash from operations, which was more than offset by \$23.3 million of net unfavorable changes in our working capital (accounts receivable, inventories and accounts payable), a \$70.0 million payment related to the settlement of our litigation with Texas Instruments, and \$18.3 million of payments for restructuring related items. The net unfavorable working capital change was mainly driven by an increase in DSO from 41 days in days in the nine month period ended September 30, 2005, to 64 days

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in the nine month period ended June 30, 2006. This DSO increase was a result of (i) the timing of shipments in the third quarter of fiscal 2006 as compared to the fourth quarter of fiscal 2005 as a result of supply availability in the third quarter of fiscal 2006 and (ii) higher levels of aged receivables at June 30, 2006 as compared to September 30, 2005. The unfavorable change in working capital due to the increase in DSO was partially offset by a reduction in our inventory balance, as inventory turns increased from 5.0 turns in the nine month period ended September 30, 2005 to 6.5 turns in the nine month period ended June 30, 2006.

Cash provided by investing activities was \$135.5 million in the first nine months of fiscal 2007 compared to cash used in investing activities of \$7.6 million in first nine months of fiscal 2006. Cash provided by investing activities in the first nine months of fiscal 2007 was attributable to \$98.1 million from the sale of our investment in Jazz Semiconductor, and \$58.4 million of net proceeds from sales and maturities of marketable securities, offset by the \$10.0 million purchase of Jazz Technologies shares, capital expenditures of \$23.1 million, primarily due to our expansion efforts in India and China and a \$5.0 million payment for the acquisition of the assets of Zarlink Semiconductor Inc. s packet switching business.

Cash used in investing activities in the first nine months of fiscal 2006 was attributable to capital expenditures of \$23.5 million primarily due to our expansion efforts in India and China, \$8.8 million of restricted cash as required under our short-term credit facility, and \$6.9 million of earnout payments related to previous business combinations, partially offset by \$27.1 million of net proceeds from sales and maturities of marketable securities and \$5.2 million of net proceeds from equity securities.

Cash used in financing activities was \$185.0 million in the first nine months of fiscal 2007 compared to cash provided by financing activities of \$84.7 million in the first nine months of fiscal 2006. Cash used in financing activities in the first nine months of fiscal 2007 primarily consisted of the retirement of \$456.5 million of our convertible subordinated notes due February 2007, partially offset by net proceeds of \$265.0 million from the issuance of floating rate senior secured notes due November 2010 and \$7.6 million of proceeds from the issuance of common stock under our stock-based employee benefit plans.

Cash provided by financing activities in the first nine months of fiscal 2006 consisted of net proceeds of \$243.6 million from the issuance of convertible subordinated notes due March 2026, \$78.5 million of net proceeds from our short-term credit facility and \$17.1 million of proceeds from the issuance of common stock under our stock-based employee benefit plans, partially offset by the retirement of \$196.8 million of our convertible subordinated notes due May 2006 and \$57.9 million of repurchases and retirements of a portion of our convertible subordinated notes due February 2007.

Contractual obligations at June 29, 2007 were as follows:

|                       |              | Payments due by period |            |            |                         |
|-----------------------|--------------|------------------------|------------|------------|-------------------------|
|                       |              | Less than<br>1<br>year | 1-3 years  | 3-5 years  | More than<br>5<br>years |
| <i>(in thousands)</i> | <b>Total</b> |                        |            |            |                         |
| Long-term debt        | \$ 525,000   | \$ 43,900              | \$         | \$ 481,100 | \$                      |
| Short-term debt       | 80,000       | 80,000                 |            |            |                         |
| Interest on debt      | 118,671      | 36,038                 | 62,106     | 20,527     |                         |
| Operating leases      | 149,341      | 27,203                 | 38,414     | 23,978     | 59,746                  |
| Capital leases        | 190          | 190                    |            |            |                         |
| Assigned leases       | 3,354        | 842                    | 1,282      | 1,230      |                         |
| Purchase commitments  | 65,015       | 43,482                 | 20,803     | 730        |                         |
| Capital commitments   | 3,611        | 3,611                  |            |            |                         |
|                       | \$ 945,182   | \$ 235,266             | \$ 122,605 | \$ 527,565 | \$ 59,746               |

As discussed above, the holders of the \$250.0 million convertible subordinated notes due March 2026 could require us to repurchase all or part of their notes as early as March 1, 2011. As a result, the convertible subordinated notes are

presented as being due in 3-5 years in the table above. Also as discussed above, we are required to offer to repurchase all or part of the \$275.0 million senior secured notes due November 2010 with the net proceeds of certain asset dispositions if such proceeds are not used within 360 days to invest in assets (other than current assets) related

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to our business. The sale of our investment in Jazz Semiconductor in February 2007 and the sale of two other equity investments in January 2007 qualify as asset dispositions requiring us to make offers to repurchase a portion of the notes no later than 361 days following the respective asset dispositions. Based on the proceeds received from these asset dispositions and our estimates of cash investments in assets (other than current assets) related to our business to be made within 360 days following the asset dispositions, we estimate that we will be required to make offers to repurchase approximately \$43.9 million of the senior secured notes, at 100% of the principal amount plus any accrued and unpaid interest, in the second quarter of fiscal 2008. As such, \$43.9 million of the senior secured notes are presented as being due in less than one year in the table above.

At June 29, 2007, the Company had many sublease arrangements on operating leases for terms ranging from near term to approximately eight years. Aggregate scheduled sublease income based on current terms is approximately \$23.8 million and is not reflected in the table above.

In October 2006, we acquired the assets of Zarlink Semiconductor Inc.'s packet switching business for \$5.0 million. Under the terms of the Zarlink acquisition, the Company may be required to pay additional amounts of up to \$1.5 million through December 31, 2007 and up to \$1.0 million through December 31, 2008 if certain revenue targets are achieved.

### **Off-Balance Sheet Arrangements**

We have made guarantees and indemnities, under which we may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions. In connection with our spin-off from Rockwell International Corporation (Rockwell), we assumed responsibility for all contingent liabilities and then-current and future litigation (including environmental and intellectual property proceedings) against Rockwell or its subsidiaries in respect of the operations of the semiconductor systems business of Rockwell. In connection with our contribution of certain of our manufacturing operations to Jazz Semiconductor, we agreed to indemnify Jazz Semiconductor for certain environmental matters and other customary divestiture-related matters. In connection with the sales of our products, we provide intellectual property indemnities to our customers. In connection with certain facility leases, we have indemnified our lessors for certain claims arising from the facility or the lease. We indemnify our directors and officers to the maximum extent permitted under the laws of the State of Delaware.

The durations of our guarantees and indemnities vary, and in many cases are indefinite. The guarantees and indemnities to customers in connection with product sales generally are subject to limits based upon the amount of the related product sales. The majority of other guarantees and indemnities do not provide for any limitation of the maximum potential future payments we could be obligated to make. We have not recorded any liability for these guarantees and indemnities in our condensed consolidated balance sheets. Product warranty costs are not significant. Under the terms of the Zarlink acquisition, the Company may be required to pay additional amounts of up to \$1.5 million through December 31, 2007 and up to \$1.0 million through December 31, 2008 if certain revenue targets are achieved. We have not recorded a liability for this contingent consideration. If earned, the contingent consideration will be recorded as additional goodwill.

### **Special Purpose Entities**

We have one special purpose entity, Conexant USA, LLC, which was formed in September 2005 in anticipation of establishing an accounts receivable financing facility. This special purpose entity is a wholly-owned, consolidated subsidiary of ours. Conexant USA, LLC is not permitted, nor may its assets be used, to guarantee or satisfy obligations of Conexant Systems, Inc. or any subsidiary of Conexant Systems, Inc.

On November 29, 2005, we established an accounts receivable financing facility whereby we will sell, from time to time, certain insured accounts receivable to Conexant USA, LLC, and Conexant USA, LLC entered into an \$80.0 million revolving credit agreement with a bank which is secured by the assets of the special purpose entity.

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### **Recent Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which permits entities to choose to measure at fair value eligible financial instruments and certain other items that are not currently required to be measured at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will adopt SFAS No. 159 no later than the first quarter of fiscal 2009. We are currently assessing the impact the adoption of SFAS No. 159 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires company plan sponsors to display the net over- or under-funded position of a defined benefit postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations or actuarial gains/losses reported as a component of other comprehensive income in shareholders equity. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. We will adopt SFAS No. 158 as of the end of fiscal 2007. We are currently assessing the impact the adoption of SFAS No. 158 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, clarifies the definition of fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the application of SFAS No. 157 may change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will adopt SFAS No. 157 in the first quarter of fiscal 2009. We are currently assessing the impact the adoption of SFAS No. 157 will have on our financial position and results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108 on Quantifying Misstatements. SAB No. 108 requires companies to use both a balance sheet and an income statement approach when quantifying and evaluating the materiality of a misstatement, and contains guidance on correcting errors under the dual approach. SAB No. 108 also provides transition guidance for correcting errors existing in prior years. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged for any interim period of the first fiscal year ending after November 15, 2006, and filed after September 13, 2006. We are currently assessing the impact, if any, SAB No. 108 will have on our financial position and results of operations.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the application of SFAS No. 109, Accounting for Income Taxes, by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise s financial statements and also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, but earlier adoption is permitted. We will adopt FIN 48 no later than the first quarter of fiscal 2008. We are currently assessing the impact the adoption of FIN 48 will have on our financial position and results of operations.

### **Critical Accounting Policies**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among the significant estimates affecting our consolidated financial statements are those relating to business combinations, revenue recognition, allowances for doubtful accounts, inventories, long-lived assets, deferred income taxes, valuation of warrants, valuation of equity securities, stock-based compensation and restructuring charges. We regularly evaluate our estimates and assumptions based upon historical experience and various other factors that we believe to be reasonable under the circumstances, the

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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. To the extent actual results differ from those estimates, our future results of operations may be affected.

***Business combinations***

We account for acquired businesses using the purchase method of accounting which requires that the assets and liabilities assumed be recorded at the date of acquisition at their respective fair values. Because of the expertise required to value intangible assets and in-process research and development (IPR&D), we typically engage a third party valuation firm to assist management in determining those values. Valuation of intangible assets and IPR&D entails significant estimates and assumptions including, but not limited to: determining the timing and expected costs to complete projects, estimating future cash flows from product sales, and developing appropriate discount rates and probability rates by project. We believe that the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions. To the extent actual results differ from those estimates, our future results of operations may be affected by incurring charges to our statements of operations. Additionally, estimates for purchase price allocations may change as subsequent information becomes available.

***Revenue recognition***

Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the sales price and terms are fixed and determinable, and (iv) the collection of the receivable is reasonably assured. These terms are typically met upon shipment of product to the customer, except for certain distributors who have unlimited contractual rights of return or for whom the contractual terms were not enforced, or when significant vendor obligations exist. Revenue with respect to sales to distributors with unlimited rights of return or for whom contractual terms were not enforced is deferred until the products are sold by the distributors to third parties. At June 29, 2007 and September 29, 2006, deferred revenue related to sales to these distributors was \$6.9 million and \$6.7 million, respectively. Revenue with respect to sales to customers to whom we have significant obligations after delivery is deferred until all significant obligations have been completed. At June 29, 2007 and September 29, 2006, deferred revenue related to shipments of products for which we have on-going performance obligations was \$3.0 million and \$6.6 million, respectively. The majority of our distributors have limited stock rotation rights, which allow them to rotate up to 10% of product in their inventory two times a year. We recognize revenue to these distributors upon shipment of product to the distributor, as the stock rotation rights are limited and we believe that we have the ability to reasonably estimate and establish allowances for expected product returns in accordance with SFAS No. 48. Development revenue is recognized when services are performed and was not significant for any periods presented. Our revenue recognition policy is significant because our revenue is a key component of our operations and the timing of revenue recognition determines the timing of certain expenses, such as sales commissions. Revenue results are difficult to predict, and any shortfall in revenues could cause our operating results to vary significantly from period to period.

***Allowance for doubtful accounts***

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We use a specific identification method for some items, and a percentage of aged receivables for others. The percentages are determined based on our past experience. If the financial condition of our customers were to deteriorate, our actual losses may exceed our estimates, and additional allowances would be required. At June 29, 2007 and September 29, 2006, our allowances for doubtful accounts were \$1.7 million and \$0.8 million, respectively.

***Inventories***

We assess the recoverability of our inventories at least quarterly through a review of inventory levels in relation to foreseeable demand, generally over twelve months. Foreseeable demand is based upon all available information, including sales backlog and forecasts, product marketing plans and product life cycle information. When the inventory on hand exceeds the foreseeable demand, we write down the value of those inventories which, at the time

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of our review, we expect to be unable to sell. The amount of the inventory write-down is the excess of historical cost over estimated realizable value. Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand or product pricing is lower than originally projected, additional inventory write-downs may be required. Further, on a quarterly basis, we assess the net realizable value of our inventories. When the estimated average selling price of our inventory net of selling expenses falls below our inventory cost, we adjust our inventory to its current estimated market value. At June 29, 2007 and September 29, 2006, our inventory reserves were \$22.6 million and \$38.4 million, respectively.

***Long-lived assets***

Long-lived assets, including fixed assets and intangible assets (other than goodwill), are continually monitored and are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The determination of recoverability is based on an estimate of undiscounted cash flows expected to result from the use of an asset and its eventual disposition. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors. Estimates of undiscounted cash flows may differ from actual cash flows due to, among other things, technological changes, economic conditions, changes to our business model or changes in operating performance. If the sum of the undiscounted cash flows (excluding interest) is less than the carrying value, an impairment loss will be recognized, measured as the amount by which the carrying value exceeds the fair value of the asset. Fair value is determined using available market data, comparable asset quotes and/or discounted cash flow models.

Goodwill is tested for impairment on an annual basis and between annual tests whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill is tested at the reporting unit level, which is defined as an operating segment or one level below the operating segment. Goodwill impairment testing is a two-step process. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and the second step of the impairment test would be unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to that excess.

Goodwill impairment testing requires significant judgment and management estimates, including, but not limited to, the determination of (i) the number of reporting units, (ii) the goodwill and other assets and liabilities to be allocated to the reporting units and (iii) the fair values of the reporting units. The estimates and assumptions described above, along with other factors such as discount rates, will significantly affect the outcome of the impairment tests and the amounts of any resulting impairment losses.

***Deferred income taxes***

We evaluate the realizability of our deferred income tax assets and assess the need for a valuation allowance quarterly. We record a valuation allowance to reduce our deferred income tax assets to the net amount that is more likely than not to be realized. Our assessment of the need for a valuation allowance is based upon our history of operating results, expectations of future taxable income and the ongoing prudent and feasible tax planning strategies available to us. In the event that we determine that we will not be able to realize all or part of our deferred income tax assets in the future, an adjustment to the deferred income tax assets would be charged against income in the period such determination is made. Likewise, in the event we were to determine that we will more likely than not be able to realize our deferred income tax assets in the future in excess of the net recorded amount, an adjustment to the deferred income tax assets would increase income in the period such determination is made. To the extent that we realize a benefit from reducing the valuation allowance on acquired deferred income tax assets, the benefit will be credited to goodwill.



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### ***Valuation of warrants***

We have a warrant to purchase 30 million shares of Mindspeed common stock. The fair value of this warrant is determined using a standard Black-Scholes-Merton valuation model with assumptions consistent with current market conditions and our intent to liquidate the warrant over a specified time period. The Black-Scholes-Merton valuation model requires the input of highly subjective assumptions, including expected stock price volatility. Changes in these assumptions, or in the underlying valuation model, could cause the fair value of the Mindspeed warrant to vary significantly from period to period.

### ***Valuation of equity securities***

We have a portfolio of strategic investments in non-marketable equity securities and also hold certain marketable equity securities. We review equity securities periodically for other-than-temporary impairments, which requires significant judgment. In determining whether a decline in value is other-than-temporary, we evaluate, among other factors, (i) the duration and extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. These reviews may include assessments of each investee's financial condition, its business outlook for its products and technology, its projected results and cash flows, the likelihood of obtaining subsequent rounds of financing and the impact of any relevant contractual equity preferences held by us or by others. We have experienced substantial impairments in the value of our equity securities over the past few years. Future adverse changes in market conditions or poor operating results of underlying investments could result in our inability to recover the carrying amounts of our investments, which could require additional impairment charges to write-down the carrying amounts of such investments.

### ***Stock-based compensation***

In December 2004, the FASB issued SFAS No. 123(R). This pronouncement amends SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires that companies account for awards of equity instruments issued to employees under the fair value method of accounting and recognize such amounts in their statements of operations. We adopted SFAS No. 123(R) on October 1, 2005. Under SFAS No. 123(R), we are required to measure compensation cost for all stock-based awards at fair value on the date of grant and recognize compensation expense in our consolidated statements of operations over the service period that the awards are expected to vest. As permitted under SFAS No. 123(R), we elected to recognize compensation cost for all options with graded vesting granted on or after October 1, 2005 on a straight-line basis over the vesting period of the entire option. For options with graded vesting granted prior to October 1, 2005, we will continue to recognize compensation cost over the vesting period following the accelerated recognition method described in FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, as if each underlying vesting date represented a separate option grant.

Under SFAS No. 123(R), we record in our consolidated statements of operations (i) compensation cost for options granted, modified, repurchased or cancelled on or after October 1, 2005 under the provisions of SFAS No. 123(R) and (ii) compensation cost for the unvested portion of options granted prior to October 1, 2005 over their remaining vesting periods using the fair value amounts previously measured under SFAS No. 123 for pro forma disclosure purposes.

Consistent with the valuation method for the disclosure-only provisions of SFAS No. 123, we use the Black-Scholes-Merton model to value the compensation expense associated with stock-based awards under SFAS No. 123(R). In addition, forfeitures are estimated when recognizing compensation expense, and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

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The Black-Scholes-Merton model requires certain assumptions to determine an option fair value, including expected stock price volatility, risk-free interest rate, and expected life of the option. The expected stock price volatility rates are based on the historical volatility of our common stock. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option or award. The average expected life represents the weighted average period of time that options or awards granted are expected to be outstanding, as calculated using the simplified method described in the Securities and Exchange Commission's SAB No. 107.

***Restructuring charges***

Restructuring activities and related charges have related primarily to reductions in our workforce and related impact on the use of facilities. The estimated charges contain estimates and assumptions made by management about matters that are uncertain at the time that the assumptions are made (for example, the timing and amount of sublease income that will be achieved on vacated property and the operating costs to be paid until lease termination, and the discount rates used in determining the present value (fair value) of remaining minimum lease payments on vacated properties). While we have used our best estimates based on facts and circumstances available at the time, different estimates reasonably could have been used in the relevant periods, the actual results may be different, and those differences could have a material impact on the presentation of our financial position or results of operations. Our policies require us to review the estimates and assumptions periodically and to reflect the effects of any revisions in the period in which they are determined to be necessary. Such amounts also contain estimates and assumptions made by management, and are reviewed periodically and adjusted accordingly.

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our financial instruments include cash and cash equivalents, marketable debt securities, marketable equity securities, the Mindspeed warrant, short-term debt and long-term debt. Our main investment objectives are the preservation of investment capital and the maximization of after tax returns on our investment portfolio. Consequently, we invest with only high credit quality issuers, and we limit the amount of our credit exposure to any one issuer. See also Part I, Item 7A, Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the fiscal year ended September 29, 2006.

Our cash, cash equivalents and marketable debt securities are not subject to significant interest rate risk due to the short maturities of these instruments. As of June 29, 2007, the carrying value of our cash, cash equivalents and marketable debt securities approximates fair value.

As of June 29, 2007, our marketable equity securities consist of 6.2 million shares of Skyworks common stock and 1.7 million shares of Jazz Technologies common stock. Marketable equity securities are subject to equity price risk. For our equity security holdings, there are risks associated with the overall state of the stock market, having available buyers for shares we may sell, and ultimately being able to liquidate the securities at a favorable price. As of June 29, 2007, a 10% decrease in equity prices would result in a decrease in the value of our marketable equity securities of approximately \$5.1 million. From July 24, 2007 to August 3, 2007, we sold 2.8 million shares of our Skyworks common stock for net proceeds of \$22.6 million at an average price of \$8.20 per share.

We hold a warrant to purchase 30 million shares of Mindspeed common stock. For financial accounting purposes, this is a derivative instrument and the fair value of the warrant is subject to significant risk related to changes in the market price of Mindspeed's common stock. As of June 29, 2007, a 10% decrease in the market price of Mindspeed's common stock would result in a decrease in the fair value of this warrant of approximately \$3.7 million. At June 29, 2007, the market price of Mindspeed's common stock was \$2.21 per share. During the nine months ended June 29, 2007, the market price of Mindspeed's common stock ranged from a low of \$1.60 per share to a high of \$2.56 per share.

Our short-term debt consists of borrowings under a 364-day credit facility. Interest related to our short-term debt is at 7-day LIBOR plus 0.6%, which is reset quarterly and was approximately 5.96% at June 29, 2007. We do not believe our short-term debt is subject to significant market risk.

Our long-term debt consists of convertible subordinated notes with interest at fixed rates and floating rate senior secured notes. Interest related to our floating rate senior secured notes is at three-month LIBOR plus 3.75%, which is reset quarterly and was approximately 9.11% at June 29, 2007. The fair value of our convertible subordinated notes is subject to significant fluctuation due to their convertibility into shares of our common stock.

The following table shows the fair values of our financial instruments as of June 29, 2007:

| <i>(in thousands)</i>                          | <b>Carrying<br/>Value</b> | <b>Fair Value</b> |
|------------------------------------------------|---------------------------|-------------------|
| Cash and cash equivalents                      | \$ 158,162                | \$ 158,162        |
| Marketable debt securities                     | 15,361                    | 15,361            |
| Marketable equity securities                   | 50,608                    | 50,608            |
| Mindspeed warrant                              | 24,339                    | 24,339            |
| Short-term debt                                | 80,000                    | 80,000            |
| Long-term debt: senior secured notes           | 275,000                   | 280,500           |
| Long-term debt: convertible subordinated notes | 250,000                   | 216,250           |

We transact business in various foreign currencies, and we have established a foreign currency hedging program utilizing foreign currency forward exchange contracts to hedge certain foreign currency transaction exposures. Under this program, from time to time, we offset foreign currency transaction gains and losses with gains and losses on the forward contracts, so as to mitigate our overall risk of foreign transaction gains and losses. We do not enter into forward contracts for speculative or trading purposes. At June 29, 2007, we had outstanding foreign currency forward exchange contracts with a notional amount of 885 million Indian Rupees, approximately \$20.6 million, maturing at various dates through January 2008 and 8.5 million Chinese Yuan, approximately \$1.1 million, maturing at various dates through July 2007. Based on the fair values of these contracts, we recorded a derivative asset of \$1.1 million at

June 29, 2007. Based on our overall currency rate exposure at June 29, 2007, a 10% change in the currency rates would not have a material effect on our financial position, results of operations or cash flows.

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**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting during the quarter ended June 29, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

***IPO Litigation*** In November 2001, Collegeware Asset Management, LP, on behalf of itself and a putative class of persons who purchased the common stock of GlobeSpan, Inc. (GlobeSpan, Inc. later became GlobespanVirata, Inc., and is now our Conexant, Inc. subsidiary) between June 23, 1999 and December 6, 2000, filed a complaint in the U.S. District Court for the Southern District of New York alleging violations of federal securities laws by the underwriters of GlobeSpan, Inc.'s initial and secondary public offerings as well as by certain GlobeSpan, Inc. officers and directors. The complaint alleges that the defendants violated federal securities laws by issuing and selling GlobeSpan, Inc.'s common stock in the initial and secondary offerings without disclosing to investors that the underwriters had (1) solicited and received undisclosed and excessive commissions or other compensation and (2) entered into agreements requiring certain of their customers to purchase the stock in the aftermarket at escalating prices. The complaint seeks unspecified damages. The complaint was consolidated with class actions against approximately 300 other companies making similar allegations regarding the public offerings of those companies during 1998 through 2000. A tentative settlement was reached in 2003. As contemplated by the settlement agreement, the District Court then certified a class, for settlement purposes only. The tentative settlement was abandoned in 2007, in light of a decision of the U.S. Court of Appeals for the Second Circuit vacating orders certifying similarly-defined classes in cases against the underwriters. We do not believe the ultimate outcome of this litigation will have a material adverse impact on our financial condition, results of operations, or cash flows.

***Class Action Suits*** In December 2004 and January 2005, we and certain of our current and former officers and directors were named as defendants in several complaints seeking monetary damages filed on behalf of all persons who purchased our common stock during a specified class period. These suits were filed in the U.S. District Court of New Jersey (New Jersey cases) and the U.S. District Court for the Central District of California (California cases), alleging that the defendants violated the Securities Exchange Act of 1934, as amended, by allegedly disseminating materially false and misleading statements and/or concealing material adverse facts. The California cases were consolidated with the New Jersey cases so that all of the class action suits, now known as *Witriol v. Conexant, et al.* (*Witriol*), were being heard in the U.S. District Court of New Jersey by the same judge. On September 1, 2005, the defendants filed their motion to dismiss the case. On November 23, 2005, the court granted the plaintiffs' motion to file a second amended complaint, which was filed on December 5, 2005. The defendants filed an amended motion to dismiss the case on February 6, 2006. Plaintiffs filed their opposition on April 24, 2006, and defendants' reply was filed on June 14, 2006. On December 4, 2006, the court dismissed the second amended complaint. Two of the three claims were dismissed with prejudice, while the third claim was dismissed without prejudice. On January 10, 2007, the parties filed a stipulation and tolling agreement with the court stating that plaintiffs would not file an appeal of the ruling dismissing two claims with prejudice and the defendants agreed to give plaintiffs' counsel until March 16, 2007 to file an amended complaint with respect to the third claim. On April 9, 2007, we and the named plaintiff agreed to settle the case as to all defendants for \$90,000, to be paid by us within 30 days of the execution of a written agreement. The settlement is now complete and the case has been dismissed in its entirety.

In addition, in February 2005, we and certain of our current and former officers and our Employee Benefits Plan Committee were named as defendants in *Graden v. Conexant, et al.*, a lawsuit filed on behalf of all persons who were participants in our 401(k) Plan (Plan) during a specified class period. This suit was filed in the U.S. District Court of New Jersey and alleges that the defendants breached their fiduciary duties under the Employee Retirement Income Security Act, as amended, to the Plan and the participants in the Plan. The plaintiff filed an amended complaint on August 11, 2005. On October 12, 2005, the defendants filed a motion to dismiss this case contending that plaintiff lacked statutory standing. The plaintiff responded to the motion to dismiss on December 30, 2005, and the defendants' reply was filed on February 17, 2006. On March 31, 2006, the judge dismissed this case and ordered it closed. Plaintiff filed a notice of appeal on April 17, 2006. The appellate argument was held on April 19, 2007. On July 31, 2007, the Third Circuit Court of Appeals vacated the District Court's order dismissing *Graden's* complaint and remanded the case for further proceedings. We believe the lawsuit is without merit and will vigorously defend the case. We do not believe the ultimate outcome of this litigation will have a material adverse impact on our financial condition, results of operations, or cash flows.



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***Shareholder Derivative Suits*** In January 2005, we and certain of our current and former directors and officers were named as defendants in purported shareholder derivative actions seeking monetary damages (now consolidated) in the California Superior Court for the County of Orange, alleging that the defendants breached their fiduciary duties, abused control, mismanaged the Company, wasted corporate assets and unjustly enriched themselves. A similar lawsuit was filed in the U.S. District Court of New Jersey in May 2005. On July 28, 2005, the California court approved a stay of the actions filed in California pending the outcome of the motion to dismiss in the *Witriol* case. We negotiated a similar stay agreement with the plaintiffs in the New Jersey case, which was approved by the District Court in New Jersey. Pursuant to the stay agreements, in the event that the parties in the *Witriol* case engaged in any negotiations, plaintiffs' counsel in the derivative cases were to be kept informed. On February 2, 2007, the District Court in New Jersey ordered a dismissal of the New Jersey case after the parties had filed a stipulation to dismiss. On March 20, 2007, the California derivative suit was also voluntarily dismissed.

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### **ITEM 1A. RISK FACTORS**

Our business, financial condition and results of operations can be impacted by a number of risk factors, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results. Any of these risks could materially and adversely affect our business, financial condition and results of operations, which in turn could materially and adversely affect the price of our common stock or other securities.

#### ***We are subject to intense competition.***

The communications semiconductor industry in general and the markets in which we compete in particular are intensely competitive. We compete worldwide with a number of United States and international semiconductor providers that are both larger and smaller than us in terms of resources and market share. We currently face significant competition in our markets and expect that intense price and product competition will continue. This competition has resulted in and is expected to continue to result in declining average selling prices for our products. We also anticipate that additional competitors will enter our markets as a result of expected growth opportunities in communications electronics, the trend toward global expansion by foreign and domestic competitors, technological and public policy changes and relatively low barriers to entry in certain markets of the industry. Moreover, as with many companies in the semiconductor industry, customers for certain of our products offer other products that compete with similar products offered by us. Many of our competitors have certain advantages over us, such as significantly greater sales and marketing, manufacturing, distribution, technical, financial and other resources.

We believe that the principal competitive factors for semiconductor suppliers in our addressed markets are:

time-to-market;

product quality, reliability and performance;

level of integration;

price and total system cost;

compliance with industry standards;

design and engineering capabilities;

strategic relationships with customers;

customer support;

new product innovation; and

access to manufacturing capacity.

Current and potential competitors also have established or may establish financial or strategic relationships among themselves or with our existing or potential customers, resellers or other third parties. These relationships may affect customers' purchasing decisions. Accordingly, it is possible that new competitors or alliances could emerge and rapidly acquire significant market share. We cannot assure you that we will be able to compete successfully against current and potential competitors.

#### ***Our success depends on our ability to timely develop competitive new products and reduce costs.***

Our operating results will depend largely on our ability to continue to introduce new and enhanced semiconductor products on a timely basis. Successful product development and introduction depends on numerous factors, including, among others:

our ability to anticipate customer and market requirements and changes in technology and industry standards;

our ability to accurately define new products;

our ability to timely complete development of new products and bring our products to market on a timely basis;

our ability to differentiate our products from offerings of our competitors;

overall market acceptance of our products;

our ability to invest in significant amounts of research and development; and

our ability to transition product development efforts between and among our sites, particularly in India and China.

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As of June 29, 2007, approximately 1,850 of our 3,170 employees are located in the Asia-Pacific region. Expansion and transition of product development efforts to other locations entails risks associated with our ability to manage the development of products at remote geographic locations, to achieve key program milestones, and to attract and retain qualified management, technical and other personnel necessary for the design and development of our products. If we experience product design or development delays as a result of the transition, or an inability to adequately staff the programs, there could be a material adverse effect on our results of operations.

We may not have sufficient resources to make the substantial investment in research and development in order to develop and bring to market new and enhanced products. Furthermore, we are required to continually evaluate expenditures for planned product development and to choose among alternative technologies based on our expectations of future market growth. We cannot assure you that we will be able to develop and introduce new or enhanced products in a timely and cost-effective manner, that our products will satisfy customer requirements or achieve market acceptance, or that we will be able to anticipate new industry standards and technological changes. We also cannot assure you that we will be able to respond successfully to new product announcements and introductions by competitors.

In addition, prices of established products may decline, sometimes significantly and rapidly, over time. We believe that in order to remain competitive we must continue to reduce the cost of producing and delivering existing products at the same time that we develop and introduce new or enhanced products. We cannot assure you that we will be successful and as a result gross margins may decline in future periods.

***We operate in the highly cyclical semiconductor industry, which is subject to significant downturns that may negatively impact our business, financial condition and results of operations.***

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles (for semiconductors and for the end-user products in which they are used) and wide fluctuations in product supply and demand. From time to time these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry, and in our business in particular. Periods of industry downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. These factors have caused substantial fluctuations in our revenues and results of operations. We have experienced these cyclical fluctuations in our business in the past and may experience them in the future.

***Our operating results may be negatively affected by substantial quarterly and annual fluctuations and market downturns.***

Our revenues, earnings and other operating results have fluctuated in the past and may fluctuate in the future. These fluctuations are due to a number of factors, many of which are beyond our control. These factors include, among others:

- changes in end-user demand for the products manufactured and sold by our customers;
- the timing of receipt, reduction or cancellation of significant orders by customers;
- seasonal customer demand;
- the gain or loss of significant customers;
- market acceptance of our products and our customers' products;
- our ability to develop, introduce and market new products and technologies on a timely basis;
- the timing and extent of product development costs;
- new product and technology introductions by competitors;
- changes in the mix of products we develop and sell;

fluctuations in manufacturing yields;

availability and cost of products from our suppliers;

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intellectual property disputes; and

the effects of competitive pricing pressures, including decreases in average selling prices of our products.

The foregoing factors are difficult to forecast, and these as well as other factors could materially adversely affect our quarterly or annual operating results.

***We may be subject to claims of infringement of third-party intellectual property rights or demands that we license third-party technology, which could result in significant expense and loss of our ability to use, make, sell, export or import our products or one or more components comprising our products.***

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. From time to time, third parties have asserted and may in the future assert patent, copyright, trademark and other intellectual property rights to technologies that are important to our business and have demanded and may in the future demand that we license their patents and technology. Any litigation to determine the validity of claims that our products infringe or may infringe these rights, including claims arising through our contractual indemnification of our customers, regardless of their merit or resolution, could be costly and divert the efforts and attention of our management and technical personnel. We cannot assure you that we would prevail in litigation given the complex technical issues and inherent uncertainties in intellectual property litigation. If litigation results in an adverse ruling we could be required to:

pay substantial damages;

cease the manufacture, use or sale of infringing products, processes or technologies;

discontinue the use of infringing technology;

expend significant resources to develop non-infringing technology; or

license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all.

***The value of our common stock may be adversely affected by market volatility.***

The trading price of our common stock fluctuates significantly and may be influenced by many factors, including:

our operating and financial performance and prospects;

our ability to repay our debt;

the depth and liquidity of the market for our common stock;

investor perception of us and the industry and markets in which we operate;

our inclusion in, or removal from, any equity market indices;

the level of research coverage of our common stock;

changes in earnings estimates or buy/sell recommendations by analysts;

general financial, domestic, international, economic and other market conditions; and

judgments favorable or adverse to us.

In addition, public stock markets have experienced, and are currently experiencing, price and trading volume volatility, particularly in the technology sectors of the market. This volatility has significantly affected the market prices of securities of many technology companies for reasons frequently unrelated to or disproportionately impacted

by the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our common stock.

***We have recently incurred substantial losses and may incur additional future losses.***

Our net loss for the first nine months of fiscal 2007 and for fiscal 2006 was \$167.7 million and \$122.6 million, respectively. We have initiated several restructuring activities to improve our operating cost structure, and our new President and Chief Executive Officer may initiate further changes. These restructuring activities include workforce reductions and will have the near-term effect of increasing our operating expenses as a result of special charges we have recorded and will record to implement these actions. Additionally, as the result of previous business combinations, we have significant amount of intangible assets for which we record amortization expense each period. If any of these intangible assets or our goodwill were determined to be impaired,

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this could also materially affect our results. The value of our warrants to purchase Mindspeed common stock may fluctuate significantly from period to period which may unfavorably impact our results. Finally, any further decline in revenue would significantly affect our results. We cannot assure you that we will be able to achieve profitability, and we may incur additional substantial losses in the future.

***The loss of a key customer could seriously impact our revenue levels and harm our business. In addition, if we are unable to continue to sell existing and new products to our key customers in significant quantities or to attract new significant customers, our future operating results could be adversely affected.***

We have derived a substantial portion of our past revenue from sales to a relatively small number of customers. As a result, the loss of any significant customer could materially and adversely affect our financial condition and results of operations.

Sales to our twenty largest customers, including distributors, represented approximately 69% and 67% of our net revenues in the first nine months of fiscal 2007 and for fiscal 2006, respectively. We expect that our largest customers will continue to account for a substantial portion of our net revenue in future periods. The identities of our largest customers and their respective contributions to our net revenue have varied and will likely continue to vary from period to period. We may not be able to maintain or increase sales to certain of our key customers for a variety of reasons, including the following:

- most of our customers can stop incorporating our products into their own products with limited notice to us and suffer little or no penalty;

- our agreements with our customers typically do not require them to purchase a minimum quantity of our products;

- many of our customers have pre-existing or concurrent relationships with our current or potential competitors that may affect the customers' decisions to purchase our products;

- our customers face intense competition from other manufacturers that do not use our products; and

- some of our customers offer or may offer products that compete with our products.

In addition, our longstanding relationships with some larger customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer certain customers favorable prices on our products. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could seriously impact our revenue and materially and adversely affect our results of operations.

***We are subject to the risks of doing business internationally.***

For the first nine months of fiscal 2007 and for fiscal 2006, approximately 92% of our net revenues were from customers located outside of the United States, primarily in the Asia-Pacific region. In addition, a significant portion of our workforce and many of our key suppliers are located outside of the United States. Our international operations consist of research and development, sales offices, and other general and administrative functions. We plan to continue our international expansion, particularly in the Asia-Pacific region. Our international operations are subject to a number of risks inherent in operating abroad. These include, but are not limited to, risks regarding:

- currency exchange rate fluctuations;

- local economic and political conditions;

- disruptions of commerce and capital or trading markets due to or related to terrorist activity or armed conflict;

- restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and trade protection measures, including export duties and quotas and customs duties and tariffs;

changes in legal or regulatory requirements;

difficulty in obtaining distribution and support;

the laws and policies of the United States and other countries affecting trade, foreign investment and loans, and import or export licensing requirements;

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tax laws, including the cost of services provided and products sold between us and our subsidiaries which are subject to review by taxing authorities; and

limitations on our ability under local laws to protect our intellectual property.

Because most of our international sales are currently denominated in U.S. dollars, our products could become less competitive in international markets if the value of the U.S. dollar increases relative to foreign currencies.

From time to time, we may enter into foreign currency forward exchange contracts to minimize risk of loss from currency exchange rate fluctuations for foreign currency commitments entered into in the ordinary course of business.

We have not entered into foreign currency forward exchange contracts for other purposes. Our financial condition and results of operations could be affected (adversely or favorably) by currency fluctuations.

We also conduct a significant portion of our international sales through distributors. Sales to distributors and other resellers accounted for approximately 33% and 35% of our net revenues for the first nine months of fiscal 2007 and for fiscal 2006, respectively. Our arrangements with these distributors are terminable at any time, and the loss of these arrangements could have an adverse effect on our operating results. For those international distributors that we account for under a deferred revenue recognition model, we rely on the distributor to provide us timely and accurate product sell through information. No assurances can be given that these international distributors will continue to provide us this information. If we are unable to obtain this information on a timely basis, or if we determine that the information we do receive is unreliable, it may affect the accuracy of amounts recorded in our consolidated financial statements, and therefore have an adverse effect on our operating results.

***We may not be able to keep abreast of the rapid technological changes in our markets.***

The demand for our products can change quickly and in ways we may not anticipate because our markets generally exhibit the following characteristics:

rapid technological developments;

rapid changes in customer requirements;

frequent new product introductions and enhancements;

short product life cycles with declining prices over the life cycle of the products; and

evolving industry standards.

For example, a portion of our analog modem business which is bundled into PCs may become debundled as Broadband Communications become more ubiquitous. Several of our PC OEM customers have indicated that the trend toward debundling may become more significant, which may have an adverse effect on both our revenues and profitability. Further, our products could become obsolete sooner than anticipated because of a faster than anticipated change in one or more of the technologies related to our products or in market demand for products based on a particular technology, particularly due to the introduction of new technology that represents a substantial advance over current technology. Currently accepted industry standards are also subject to change, which may contribute to the obsolescence of our products.

***We face a risk that capital needed for our business and to repay our debt obligations will not be available when we need it.***

At June 29, 2007, we had a total of \$250.0 million aggregate principal amount of convertible subordinated notes outstanding. These notes are due in March 2026, but the holders may require us to repurchase, for cash, all or part of their notes on March 1, 2011, March 1, 2016 and March 1, 2021 at a price of 100% of the principal amount, plus any accrued and unpaid interest.

At June 29, 2007, we also had a total of \$275.0 million aggregate principal amount of floating rate senior secured notes outstanding. These notes are due in November 2010, but we are required to offer to repurchase, for cash, notes at a price of 100% of the principal amount, plus any accrued and unpaid interest, with the net proceeds of certain asset dispositions if such proceeds are not used within 360 days to invest in assets (other than current assets) related to our

business. The sale of our investment in Jazz Semiconductor in February 2007 and the sale of two other

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equity investments in January 2007 qualify as asset dispositions requiring us to make offers to repurchase a portion of the notes no later than 361 days following the respective asset dispositions. Based on the proceeds received from these asset dispositions and our estimates of cash investments in assets (other than current assets) related to our business to be made within 360 days following the asset dispositions, we estimate that we will be required to make offers to repurchase approximately \$43.9 million of the senior secured notes, at 100% of the principal amount plus any accrued and unpaid interest, in the second quarter of fiscal 2008.

We also have an \$80.0 million credit facility with a bank, under which we had borrowed \$80.0 million as of June 29, 2007. The term of this credit facility has been extended through November 28, 2007, and the facility remains subject to additional 364-day extensions at the discretion of the bank.

We may not have access to sufficient capital to repay amounts due under (i) our credit facility expiring November 2007 if it is not renewed, (ii) our floating rate senior secured notes when they become due in November 2010 or earlier as a result of a mandatory offer to repurchase, and (iii) our convertible subordinated notes when they become due in March 2026 or earlier as a result of the mandatory repurchase requirements. Further, we may not be able to refinance any portion of this debt on favorable terms or at all.

In the future, we may need to make strategic investments and acquisitions to help us grow our business, which may require additional capital resources. We cannot assure you that the capital required to fund these investments and acquisitions will be available in the future.

***We may not be able to attract and retain qualified management, technical and other personnel necessary for the design, development and sale of our products. Our success could be negatively affected if key personnel leave.***

Our future success depends on our ability to attract and to retain the continued service and availability of skilled personnel, including members of our executive team, and those in design, technical, marketing and staff positions. As the source of our technological and product innovations, our key technical personnel represent a significant asset. The competition for such personnel can be intense in the semiconductor industry. While we have entered into employment agreements with some of our key personnel, we cannot assure you that we will be able to attract and retain qualified management and other personnel necessary for the design, development and sale of our products.

In addition, we have relied on our ability to grant stock options as one mechanism for recruiting and retaining highly skilled talent. Recent accounting regulations requiring the expensing of stock options may impair our future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that we will continue to successfully attract, motivate, and retain key personnel.

***If OEMs of communications electronics products do not design our products into their equipment, we will be unable to sell those products. Moreover, a design win from a customer does not guarantee future sales to that customer.***

Our products are not sold directly to the end-user but are components of other products. As a result, we rely on OEMs of communications electronics products to select our products from among alternative offerings to be designed into their equipment. We may be unable to achieve these design wins. Without design wins from OEMs, we would be unable to sell our products. Once an OEM designs another supplier's semiconductors into one of its product platforms, it will be more difficult for us to achieve future design wins with that OEM's product platform because changing suppliers involves significant cost, time, effort and risk. Achieving a design win with a customer does not ensure that we will receive significant revenues from that customer and we may be unable to convert design wins into actual sales. Even after a design win, the customer is not obligated to purchase our products and can choose at any time to stop using our products if, for example, it or its own products are not commercially successful.

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***Because of the lengthy sales cycles of many of our products, we may incur significant expenses before we generate any revenues related to those products.***

Our customers may need six months or longer to test and evaluate our products and an additional six months or more to begin volume production of equipment that incorporates our products. The lengthy period of time required also increases the possibility that a customer may decide to cancel or change product plans, which could reduce or eliminate sales to that customer. As a result of this lengthy sales cycle, we may incur significant research and development, and selling, general and administrative expenses before we generate the related revenues for these products, and we may never generate the anticipated revenues if our customer cancels or changes its product plans.

***Uncertainties involving the ordering and shipment of our products could adversely affect our business.***

Our sales are typically made pursuant to individual purchase orders and we generally do not have long-term supply arrangements with our customers. Generally, our customers may cancel orders until 30 days prior to shipment. In addition, we sell a portion of our products through distributors and other resellers, some of whom have a right to return unsold products to us. Sales to distributors and other resellers accounted for approximately 33% and 35% of our net revenues for the first nine months of fiscal 2007 and for fiscal 2006, respectively. Our distributors may offer products of several different suppliers, including products that may be competitive with ours. Accordingly, there is a risk that the distributors may give priority to other supplier products and may not sell our products as quickly as forecasted, which may impact their future order levels. We routinely purchase inventory based on estimates of end-market demand for our customers' products, which is difficult to predict. This difficulty may be compounded when we sell to OEMs indirectly through distributors and other resellers or contract manufacturers, or both, as our forecasts of demand are then based on estimates provided by multiple parties. In addition, our customers may change their inventory practices on short notice for any reason. The cancellation or deferral of product orders, the return of previously sold products or overproduction due to the failure of anticipated orders to materialize could result in our holding excess or obsolete inventory, which could result in write-downs of inventory. For example, the reduced demand outlook for fiscal year 2005 and decline of average selling prices for certain of our products resulted in net inventory charges of approximately \$45.0 million in the first quarter of fiscal 2005.

***We are dependent upon third parties for the manufacture, assembly and test of our products.***

We are entirely dependent upon outside wafer fabrication facilities (known as foundries or fabs), including Jazz Semiconductor which was sold to Jazz Technologies in February 2007. Under our fabless business model, our revenue growth is dependent on our ability to obtain sufficient external manufacturing capacity, including wafer production capacity. If the semiconductor industry experiences a shortage of wafer fabrication capacity in the future, we may experience delays in shipments or increased manufacturing costs.

There are significant risks associated with our reliance on third-party foundries, including:

the lack of assured wafer supply, potential wafer shortages and higher wafer prices;

limited control over delivery schedules, manufacturing yields, production costs and product quality; and

the unavailability of, or delays in obtaining, access to key process technologies.

The foundries we use may allocate their limited capacity to fulfill the production requirements of other customers that are larger and better financed than us. If we choose to use a new foundry, it typically takes several months to redesign our products for the process technology and intellectual property cores of the new foundry and to complete the qualification process before we can begin shipping products from the new foundry.

We are also dependent upon third parties for the assembly and test of our products. Our reliance on others to assemble and test our products subjects us to many of the same risks as are described herein with respect to our reliance on outside wafer fabrication facilities.

Wafer fabrication processes are subject to obsolescence, and foundries may discontinue a wafer fabrication process used for certain of our products. In such event, we generally offer our customers a "last time buy" program to satisfy their anticipated requirements for our products. The unanticipated discontinuation of wafer fabrication processes on which we rely may adversely affect our revenues and our customer relationships.



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The foundries and other suppliers on whom we rely may experience financial difficulties or suffer disruptions in their operations due to causes beyond our or their control, including labor strikes, work stoppages, electrical power outages, fire, earthquake, flooding or other natural disasters. Certain of our suppliers' manufacturing facilities are located near major earthquake fault lines in California and the Asia-Pacific region. In the event of a disruption of the operations of one or more of our suppliers, we may not have a second manufacturing source immediately available. Such an event could cause significant delays in shipments until we could shift the products from an affected facility or supplier to another facility or supplier. The manufacturing processes we rely on are specialized and are available from a limited number of suppliers. Alternate sources of manufacturing capacity, particularly wafer production capacity, may not be available to us on a timely basis. Even if alternate wafer production capacity is available, we may not be able to obtain it on favorable terms, or at all. Difficulties or delays in securing an adequate supply of our products on favorable terms, or at all, could impair our ability to meet our customers' requirements and have a material adverse effect on our operating results.

In addition, the highly complex and technologically demanding nature of semiconductor manufacturing has caused foundries from time to time to experience lower than anticipated manufacturing yields, particularly in connection with the introduction of new products and the installation and start-up of new process technologies. Lower than anticipated manufacturing yields may affect our ability to fulfill our customers' demands for our products on a timely basis. Moreover, lower than anticipated manufacturing yields may adversely affect our cost of goods sold and our results of operations.

***We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries, increased expenses and loss of design wins to our competitors.***

To remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller line width geometries. This transition requires us to modify the manufacturing processes for our products and to redesign some products as well as standard cells and other integrated circuit designs that we may use in multiple products. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. Currently our products are manufactured in a variety of process technologies ranging from 0.8 micron technology, which is our most mature technology, to 90 nanometer, which is the most advanced. We currently have product development efforts underway at the 65 nanometer process technology node. In the past, we have experienced some difficulties in shifting to smaller geometry process technologies or new manufacturing processes, which resulted in reduced manufacturing yields, delays in product deliveries and increased expenses. We may face similar difficulties, delays and expenses as we continue to transition our products to smaller geometry processes. We are dependent on our relationships with our foundries to transition to smaller geometry processes successfully. We cannot assure you that our foundries will be able to effectively manage the transition or that we will be able to maintain our existing foundry relationships or develop new ones. If our foundries or we experience significant delays in this transition or fail to implement this transition efficiently, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, all of which could negatively affect our relationships with our customers and result in the loss of design wins to our competitors, which in turn would adversely affect our results of operations. As smaller geometry processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as customer and third party intellectual property, into our products. However, we may not be able to achieve higher levels of design integration or deliver new integrated products on a timely basis, or at all. Moreover, even if we are able to achieve higher levels of design integration, such integration may have a short-term adverse impact on our operating results, as we may reduce our revenue by integrating the functionality of multiple chips into a single chip.

***If we are not successful in protecting our intellectual property rights, it may harm our ability to compete.***

We use a significant amount of intellectual property in our business. We rely primarily on patent, copyright, trademark and trade secret laws, as well as nondisclosure and confidentiality agreements and other methods, to protect our proprietary technologies and processes. At times we incorporate the intellectual property of our customers into our designs, and we have obligations with respect to the non-use and non-disclosure of their intellectual property. In the past, we have engaged in litigation to enforce our intellectual property rights, to protect our trade secrets or to

determine the validity and scope of proprietary rights of others, including our customers. We

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may engage in future litigation on similar grounds, which may require us to expend significant resources and to divert the efforts and attention of our management from our business operations. We cannot assure you that:

the steps we take to prevent misappropriation or infringement of our intellectual property or the intellectual property of our customers will be successful;

any existing or future patents will not be challenged, invalidated or circumvented; or

any of the measures described above would provide meaningful protection.

Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our technology without authorization, develop similar technology independently or design around our patents. If any of our patents fails to protect our technology it would make it easier for our competitors to offer similar products. In addition, effective patent, copyright, trademark and trade secret protection may be unavailable or limited in certain countries.

### ***Uncertainties involving litigation could adversely affect our business.***

We and certain of our current and former officers and directors have been named as defendants in several purported securities class action lawsuits, which have now been consolidated into a single action. We and certain of our directors and officers have also been named as defendants in purported shareholder derivative actions. We and certain of our current and former officers and our Employee Benefits Plan Committee have also been named as defendants in a purported breach of fiduciary duties action. Although we believe that these lawsuits are without merit, an adverse determination could have a negative impact on the price of our stock. Moreover, regardless of the ultimate result, the lawsuits may divert management's attention and resources from other matters, which could also adversely affect our business and results of operations.

### ***Our success depends, in part, on our ability to effect suitable investments, alliances and acquisitions.***

Although we invest significant resources in research and development activities, the complexity and speed of technological changes make it impractical for us to pursue development of all technological solutions on our own. On an ongoing basis, we review investment, alliance and acquisition prospects that would complement our existing product offerings, augment our market coverage or enhance our technological capabilities. However, we cannot assure you that we will be able to identify and consummate suitable investment, alliance or acquisition transactions in the future.

Moreover, if we consummate such transactions, they could result in:

large initial one-time write-offs of in-process research and development;

the incurrence of substantial debt and assumption of unknown liabilities;

the potential loss of key employees from the acquired company;

amortization expenses related to intangible assets; and

the diversion of management's attention from other business concerns.

Integrating acquired organizations and their products and services may be expensive, time-consuming and a strain on our resources and our relationships with employees and customers, and ultimately may not be successful. The process of integrating operations could cause an interruption of, or loss of momentum in, the activities of one or more of our product lines and the loss of key personnel. The diversion of management's attention and any delays or difficulties encountered in connection with acquisitions and the integration of multiple operations could have an adverse effect on our business, results of operations or financial condition.

### ***We have significant goodwill and intangible assets, and future impairment of our goodwill and intangible assets could have a material negative impact on our financial condition and results of operations.***

At June 29, 2007, we had \$580.7 million of goodwill and \$41.1 million of intangible assets, net, which together represented approximately 52% of our total assets. In periods subsequent to an acquisition, at least on an annual basis or when indicators of impairment exist, we must evaluate goodwill and acquisition-related intangible assets for

impairment. When such assets are found to be impaired, they will be written down to estimated fair value, with a

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charge against earnings. If our market capitalization drops below our book value for a prolonged period of time, if our assumptions regarding our future operating performance change or if other indicators of impairment are present, we may be required to write-down the value of our goodwill and acquisition-related intangible assets by taking a non-cash charge against earnings. During the second quarter of fiscal 2007, we recorded goodwill and intangible asset impairment charges of \$135.0 million and \$20.0 million, respectively, which had a material negative impact on our results of operations. Because of the significance of our remaining goodwill and intangible asset balances, any future impairment of these assets could also have a material adverse effect on our financial condition and results of operations, although, as a non-cash charge, it would have no effect on our cash flow.

***We may be liable for penalties under environmental laws, rules and regulations, which could adversely impact our business.***

Our former manufacturing operations used a variety of chemicals and were subject to a wide range of environmental protection regulations in the United States and Mexico. We have been designated as a potentially responsible party and are engaged in groundwater remediation under a previously approved Consent Decree at one Superfund site located at a former silicon wafer manufacturing facility and steel fabrication plant in Parker Ford, Pennsylvania formerly occupied by us, which has been settled pursuant to a Consent Decree entered into with the EPA in August 2006. In addition, we are engaged in remediations of groundwater contamination at our former Newport Beach, California wafer fabrication facility. We estimate the remaining costs for these remediations to be approximately \$1.2 million as of June 29, 2007 and have accruals for these costs in our consolidated balance sheets. In the United States, environmental regulations often require parties to fund remedial action regardless of fault. Consequently, it is often difficult to estimate the future impact of environmental matters, including potential liabilities. While we have not experienced any material adverse effects on our operations as a result of such regulations, we cannot assure you that the costs that might be required to complete remedial actions, if any, will not have a material adverse effect on our business, financial condition and results of operations.

***We may be limited in the future in the amount of net operating losses that we can use to offset taxable income.***

As of June 29, 2007, we had approximately \$1.3 billion of U.S. federal income tax net operating loss (NOL) carry forwards that can be used to offset taxable income in subsequent years. Approximately \$753.0 million of the NOL carry forwards were acquired in the merger with GlobespanVirata and in other acquisitions. The NOL carry forwards are scheduled to expire at various dates through 2026. Section 382 of the Internal Revenue Code could limit the future use of some or all of the NOL carry forwards if the ownership of our common stock changes by more than 50 percentage points in certain circumstances over a three-year testing period. Based on information known to us, we have not undergone such a change of ownership and the merger did not constitute a change of ownership, although the shares of our common stock issued in the merger will be taken into account in any change of ownership computations. Direct or indirect transfers of our common stock, when taken together with the shift in ownership resulting from the merger, could result in a change of ownership that would trigger the Section 382 limitation. If such an ownership change occurs, Section 382 would limit our use of NOL carry forwards in each subsequent taxable year to an amount equal to a federal long-term tax-exempt rate published by the Internal Revenue Service at the time of the ownership change, multiplied by our fair market value at such time; any unused annual limitation amounts may also be carried forward. The merger resulted in a change of ownership of GlobespanVirata and the future use of GlobespanVirata's NOL carry forwards is subject to the Section 382 limitation (or further limitation in the case of NOL carry forwards already subject to limitation as a result of previous transactions) based on the fair market value of GlobespanVirata at the time of the merger.

***Provisions in our organizational documents and rights agreement and Delaware law may make it difficult for someone to acquire control of us.***

We have established certain anti-takeover measures that may affect our common stock and convertible notes. Our restated certificate of incorporation, our by-laws, our rights agreement with Mellon Investor Services LLC, as rights agent, dated as of November 30, 1998, as amended, and the Delaware General Corporation Law contain several provisions that would make more difficult an acquisition of control of us in a transaction not approved by our board of directors. Our restated certificate of incorporation and by-laws include provisions such as:



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the division of our board of directors into three classes to be elected on a staggered basis, one class each year;

the ability of our board of directors to issue shares of our preferred stock in one or more series without further authorization of our shareholders;

a prohibition on shareholder action by written consent;

a requirement that shareholders provide advance notice of any shareholder nominations of directors or any proposal of new business to be considered at any meeting of shareholders;

a requirement that a supermajority vote be obtained to remove a director for cause or to amend or repeal certain provisions of our restated certificate of incorporation or by-laws;

elimination of the right of shareholders to call a special meeting of shareholders; and

a fair price provision.

Our rights agreement gives our shareholders certain rights that would substantially increase the cost of acquiring us in a transaction not approved by our board of directors.

In addition to the rights agreement and the provisions in our restated certificate of incorporation and by-laws, Section 203 of the Delaware General Corporation Law generally provides that a corporation shall not engage in any business combination with any interested shareholder during the three-year period following the time that such shareholder becomes an interested shareholder, unless a majority of the directors then in office approves either the business combination or the transaction that results in the shareholder becoming an interested shareholder or specified shareholder approval requirements are met.

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**ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1               | Employment agreement dated June 21, 2007, between the Company and Daniel A. Artusi.                                                                                                                                                                                                               |
| 10.2               | Form of Restricted Stock Unit Award Agreement under the Conexant Systems, Inc. 2004 New-Hire Equity Incentive Plan.                                                                                                                                                                               |
| 10.3               | Schedule identifying agreements substantially similar to the Form of Indemnity Agreement constituting Exhibit 10-q-1 to the Company's Annual Report on Form 10-K for the year ended September 30, 2004, entered into between the Company and the directors and certain executives of the Company. |
| 31.1               | Certification of the Chief Executive Officer of Periodic Report Pursuant to Rule 13a-15(e) or 15d-15(e).                                                                                                                                                                                          |
| 31.2               | Certification of the Chief Financial Officer of Periodic Report Pursuant to Rule 13a-15(e) or 15d-15(e).                                                                                                                                                                                          |
| 32                 | Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.                                                                                                                                                                       |

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**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.

CONEXANT SYSTEMS, INC.  
(Registrant)

Date: August 6, 2007

By /s/ J. Scott Blouin  
J. Scott Blouin  
Senior Vice President and Chief  
Financial Officer  
(principal financial officer)

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**EXHIBIT INDEX**

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