CONEXANT SYSTEMS INC
Form 10-K
December 08, 2005

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

Form 10-K

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

For the fiscal year ended September 30, 2005

Commission file number: 000-24923

CONEXANT SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**25-1799439**
(State of incorporation)	*(I.R.S. Employer Identification No.)*
4000 MacArthur Boulevard **Newport Beach, California** *(Address of principal executive offices)*	**92660-3095** *(Zip code)*

Registrant s telephone number, including area code:
(949) 483-4600
Securities registered pursuant to Section 12(b) of the Act:
NONE
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.01 Par Value Per Share
(including associated Preferred Share Purchase Rights)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

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

The aggregate market value of the Registrant s voting stock held by non-affiliates of the Registrant (based on the closing price as reported on the Nasdaq National Market on April 1, 2005) was approximately $680 million. Shares of

voting stock held by each officer and director and by each shareowner affiliated with a director have been excluded from this calculation because such persons may be deemed to be affiliates. This determination of officer or affiliate status is not necessarily a conclusive determination for other purposes. The number of outstanding shares of the Registrant s Common Stock as of November 25, 2005 was 474,281,719.

Documents Incorporated by Reference

Portions of the Registrant s Proxy Statement for the 2006 Annual Meeting of Shareowners to be held on February 22, 2006, are incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY STATEMENT

This Annual Report on Form 10-K 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: general economic and political conditions and conditions in the markets we address; the substantial losses we have incurred; the cyclical nature of the semiconductor industry and the markets addressed by our products and our customers products; 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; the timing of new product introductions and product quality; our ability to anticipate trends and develop products for which there will be market demand; the availability of manufacturing capacity; pricing pressures and other competitive factors; changes in product mix; product obsolescence; the ability of our customers to manage inventory; the ability to develop and implement new technologies and to obtain protection for the related intellectual property; the uncertainties of litigation and the demands it may place on the time and attention of our management; 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.

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PART I

Item 1. *Business*

General

Conexant Systems, Inc. (we, 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), television set-top boxes and game consoles 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 optical fiber networks to homes and businesses around the globe. 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. The Company operates in one reportable segment (see Notes 1 and 17 of Notes to Consolidated Financial Statements).

On February 27, 2004, we completed our merger with GlobespanVirata, Inc. (GlobespanVirata) with GlobespanVirata becoming a wholly-owned subsidiary of the Company. For accounting purposes, the transaction was accounted for under the purchase method of accounting with the Company as the acquirer. In exchange for 100% of the outstanding shares of common stock of GlobespanVirata (approximately 150.7 million shares), we issued 1.198 shares of Conexant common stock for each share of GlobespanVirata common stock outstanding (or approximately 180.6 million shares of Conexant common stock) and each outstanding option and warrant to purchase GlobespanVirata common stock was adjusted and converted into an option or warrant to purchase Conexant common stock based on the 1.198 merger ratio (or approximately 43.6 million options and warrants to purchase shares of Conexant common stock). In May 2004, the GlobespanVirata, Inc. subsidiary was renamed Conexant, Inc., and hereinafter will be referred to as Conexant, Inc., and the overall business combination is hereinafter referred to as the Merger.

On June 27, 2003, we completed the distribution to our shareholders of all outstanding shares of our wholly owned subsidiary Mindspeed Technologies, Inc. (Mindspeed), to which we contributed our Internet infrastructure business, including the stock of certain subsidiaries, and certain other assets and liabilities, including $100.0 million in cash (hereinafter, the Mindspeed Spin). In the Mindspeed Spin, Conexant shareholders received one share of Mindspeed common stock for every three Conexant shares held and the Conexant shareholders continued to hold their Conexant shares. Mindspeed issued us a warrant to purchase 30 million shares of Mindspeed common stock, representing approximately 20 percent of Mindspeed s outstanding common stock on a fully diluted basis. The warrant is exercisable until June 27, 2013 at an exercise price of $3.408 per share. The fair value of the warrant is recorded as an asset on our consolidated balance sheet. Additionally, we entered into a senior secured revolving credit facility pursuant to which Mindspeed could have borrowed up to $50.0 million, subject to certain restrictions, for working capital and general corporate purposes. In December 2004, the Mindspeed credit facility was terminated (see Note 11 of Notes to Consolidated Financial Statements).

On June 25, 2002, we completed the distribution to our shareholders of outstanding shares of our wholly owned subsidiary Washington Sub, Inc. (Washington), to which we contributed our wireless communications business, other than certain assets and liabilities which we retained. Immediately thereafter, Washington merged with and into Alpha Industries, Inc. (Alpha), with Alpha the surviving corporation. As a result of these transactions, Conexant shareholders received 0.351 of a share of Alpha common stock for each Conexant share held and the Conexant shareholders continued to hold their Conexant shares. Upon completion of these events, Alpha and its subsidiaries purchased our semiconductor assembly and test facility located in Mexicali, Mexico and our package design team that supports the Mexicali facility (together, the Mexicali Operations) for $150.0 million. Effective June 26, 2002, Alpha changed its name to Skyworks

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Solutions, Inc. (Skyworks). All these transactions, on a combined basis, are hereinafter referred to as the Skyworks Spin.

In March 2002, we and The Carlyle Group formed a new specialty foundry company named Jazz Semiconductor, Inc. (Jazz). We contributed our Newport Beach, California wafer fabrication operations and related assets and liabilities and certain intellectual property to Jazz in exchange for $19.3 million in cash and a 45% equity interest in Jazz, having an estimated fair value of $42.5 million. In fiscal 2003, another party made an additional investment in Jazz thereby reducing our equity interest to 38%.

Except where otherwise noted, the financial information contained herein represents our continuing operations, excluding the discontinued wireless communications business, Mexicali Operations and the Mindspeed business, and including the results of operations of GlobespanVirata since February 28, 2004, following the completion of the Merger.

Our Business

We design, develop and sell semiconductor system solutions for use in broadband communications, enterprise networks and digital home networks worldwide. Our expertise in mixed-signal processing, digital signal processing (DSP) and standards-based communications protocol implementation allows us to deliver semiconductor devices and integrated systems for client, or end-customer, personal communications access products. These products include PCs and PC peripheral products, television set-top boxes, residential gateways, game consoles, point-of-sale (POS) terminals, multi-function peripherals (MFPs) and other types of consumer and enterprise products. These communications access end-products connect to audio, video, voice and data services over broadband wireline communications networks, including digital subscriber line (DSL), cable and Ethernet, over dial-up Internet connections, over wireless local area networks and over direct broadcast satellite, terrestrial and fixed wireless systems. We also design, develop and sell semiconductor system solutions used in telecommunications company central office (CO) equipment, primarily in DSL access multiplexers (DSLAMs).

We organize our product lines to address four primary communications end-markets. First, our broadband access products include a comprehensive portfolio of DSL products designed for customer premises equipment (CPE) and CO applications in addition to products designed for emerging passive optical network (PON) applications. Second, our broadband media processing products include a variety of broadcast audio and video decoder and encoder devices as well as front-end communications components that enable the capture, display, storage, playback and transfer of audio and video content in digital home and small office products such as PCs, television set-top boxes, gaming consoles, personal video recorders and digital versatile disk (DVD) applications. Third, our universal and voice access products include a broad portfolio of analog modem chipsets and software for desktop and notebook PC applications as well as embedded equipment applications, including fax machines, MFPs, POS terminals, television set-top boxes, gaming consoles and Internet terminals. This product area also includes our voice-over-Internet protocol (VoIP) products designed to accommodate the transmission of voice traffic within broadband IP packet-based networks. And fourth, our wireless networking products include various combinations of radio frequency (RF) transceivers, analog base-band integrated circuits and digital base-band and medium or media access controller (MAC) chips that comply with the various configurations of the 802.11 wireless local area networking (WLAN) standard.

The following is a brief description of each of our target markets and the silicon solutions that we provide for each market.

Broadband Access Products

DSL technologies enable broadband data traffic over twisted pair copper telephone lines. Actual DSL speeds realized by the consumer range between 128 kilobits per second (kbps) and 100 megabits per second (Mbps). Faster data rates allow local exchange carriers to provide their customers with an array of new broadband services, including the transport of high definition video content in real time.

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We possess a comprehensive portfolio of standards-based DSL line codes, including asymmetric DSL (ADSL), symmetric DSL (SDSL), ADSL2, ADSL2plus and both new versions of very-high-speed DSL (VDSL and VDSL2), including the unique configurations of DSL for North America, Europe, Japan and China. We have shipped nearly 150 million DSL ports to customers around the globe.

Our DSL product portfolio is comprised of a family of System-on-Chip (SoC) integrated circuits (ICs) for use in home and business DSL products that incorporate a combination of multiple system functions. We offer solutions for both CO and CPE applications. Our DSL product offerings include various combinations of digital signal processors, network or communication processors, integrated software on silicon, and analog front-end chips, line drivers and reference design guides to help our customers deploy DSL modems, routers, residential gateways, and DSLAMs located in telephone service providers central offices.

Our DSL engineering support includes our advanced software-based development tools which allow original design manufacturers (ODMs), service providers and telecom companies to analyze, configure and troubleshoot their DSL networks remotely, saving time and expense. Our ISOS^{tm} software works in combination with our semiconductor devices to manage data, routing, bridging, switching and protocol conversions needed to encapsulate and route information packets. ISOS^{tm} is available on a variety of our platforms, and facilitates the rapid integration of new features, which enables manufacturers to streamline the product development process and improve time-to-market. Additional features of these products include system management, firewall security, embedded web server, auto-configuration of DSL services and Universal Plug-and-Play. We also offer customers a full set of software development tools including compilers, linkers and other special-purpose tools to enable the customer to design additional applications.

In May 2005, we introduced our Accelity family of highly integrated VDSL and VDSL2 CO and CPE semiconductor solutions for asynchronous transfer mode (ATM) and packet-based DSLAMs and client-side terminals. VDSL and VDSL2 technologies are targeted at voice, video and data triple-play broadband service deployments, remote terminal and fiber extension applications. VDSL2 technology provides higher downstream and upstream data rates than ADSL and ADSL2plus, and longer reach connectivity than VDSL. The Accelity chipset family is based on industry-standard discrete multi-tone (DMT) line code technology, and is compliant with the ratified VDSL2/ G.993.2 standard. According to industry analyst firm IDC, VDSL integrated circuit (IC) port shipments are expected to increase from 6.2 million ports in 2003 to 17.8 million ports in 2008, a 23 percent compound annual growth rate.

In July 2005, we announced our entry into the fiber access market with our integrated Xenon SoC solution. This new device is targeted at optical network terminals on the client-side of broadband passive optical networks (PONs). PONs provide cost-effective, high-speed last mile broadband connections to homes and businesses over a fiber optic cable, and are a significant improvement over coaxial cable or copper-based connections. The Xenon SoC solution can also be used in conjunction with our Accelity chipset to provide fiber-to-the-neighborhood, enabling the cost-effective delivery of triple-play services. Xenon is the first in a planned family of PON devices. Xenon supports downstream data rates of 622 Mbps and upstream rates of 155 Mbps. An optimized version for multiple dwelling unit applications provides 25 percent greater throughput.

In October 2005, we introduced a new ADSL2plus chipset for client-side gateway applications. Key features of the new device include an integrated two-channel VoIP processor and dual high-speed USB 2.0 interfaces that can be used to attach peripherals such as WLAN devices, storage products, printers and Web-based digital cameras directly to the DSL gateway. In addition, the chipset is upgradeable to VDSL/ VDSL2 technology, allowing manufacturers to maximize their engineering and software investments while migrating to new DSL technologies. This device is targeted at products including DSL bridge/routers, wireless DSL routers, and DSL VoIP integrated access devices (IADs).

Broadband Media Processing Products

MPEG is a set of international digital video and audio compression standards and file formats, and is one of the enabling technologies for broadband multimedia delivery. There are three major MPEG standards: MPEG-1, MPEG-2 and MPEG-4. MPEG-4 AVC/ H.264 (also known as MPEG-4 Part 10) codecs provide

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compression performance that delivers more than 50 percent greater efficiency than MPEG-2. This allows service providers to maximize bandwidth usage and efficiently deliver sophisticated programs containing audio, video, text, graphics and interactivity to their subscribers. The technology has gained wide support recently in satellite TV, IP video, video telephony, high definition DVD and wireless consumer electronics applications, and is emerging as the next major technology of choice for television video transmission and storage applications as the demand for high definition television (HDTV) services and content rapidly increases.

Our broadband media processing product offerings include devices and system-level solutions for the television set-top box market as well as products for other convergence video applications.

Set-top Box (STB) Products

In the STB family, we offer an extensive portfolio of components and system level solutions enabling digital cable, satellite and terrestrial STBs. Our product offerings include silicon tuners, satellite demodulators, MPEG audio and video decoders, and dial-up modems for back-channel applications. Reference designs that help manufacturers reduce cost and speed time-to-market are also offered, bundled with a range of operating systems, middleware, drivers and development tools.

A typical STB is comprised of front-end components and back-end components. Among the front-end components, sometimes referred to as the communications portion of the design, tuners and demodulators are employed to receive and prepare audio and video signals from a satellite, cable or terrestrial network and back-channel modems are used to communicate with the service provider. In the back-end, integrated MPEG decoders are designed to process the audio and video signals and to control the STB application software while video encoders format the video signal for display on either an analog or digital television.

We built upon our customer relationships established through our leadership in satellite front-end products to gain our first back-end product design wins in fiscal 2004. We introduced and began shipments of our new single-chip solution that incorporated demodulation, MPEG processing, audio and video outputs, graphic processing, back-channel communications capability and a control processor. Combined with one of our silicon tuner devices, this product offers a complete cost-effective STB solution for satellite, cable and terrestrial networks.

Our cable modem product portfolio includes our single-package cable modem solution containing an embedded microprocessor-based media access controller for North American Data Over Cable Service Interface Specification (DOCSIS), European DOCSIS and digital video broadcasting (DVB) applications. Our cable modem products are DOCSIS 1.0, DOCSIS 1.1, and DOCSIS 2.0 compliant. We also offer a single-chip silicon-based digital tuner, which supports both DOCSIS and DVB/ Digital Audio Visual Council (DAVIC) standards for computer cable modems and set-top boxes. This device interfaces seamlessly with our digital cable transceiver solutions. Our cable modem technology is capable of delivering data, video, telephone and Internet access over existing coaxial cable networks at speeds up to 1,000 times faster than a standard voiceband analog modem. In addition, our product supports the PCI, USB and Ethernet interfaces for connection with a PC and our customers have used this solution to successfully complete the rigorous North American CableLabs and European tComLabs certifications. These certifications give consumers and cable operators the assurance that systems comply with DOCSIS specifications and will be interoperable among multiple cable modem vendors.

In late November 2004, we introduced a family of next-generation MPEG-4 AVC/ H.264 video decoders for high-definition digital broadcast television systems. This family of decoders enables digital broadcast TV service providers to improve bandwidth utilization, allowing the cost-effective delivery of a wider range of video, voice, and data broadcast programming. H.264 compression provides greater recording capacity on STBs with personal video recording capabilities, increases the number of HDTV channels that a broadcaster can transmit, and enables live broadcast-quality video content over the Internet.

In June 2005, we introduced our dual-channel RF satellite tuner. This low-power, direct down conversion device is intended for high-volume STB receivers used for personal and digital video recording (PVR/ DVR)

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applications. The highly integrated device supports 8PSK and DVB-S2 advanced modulation and coding specifications, which provide satellite operators with higher data rates and increased capacity to deliver additional HDTV channels and services using existing bandwidth and infrastructure. The dual-channel tuner can also be used with our advanced modulation satellite demodulators to provide a complete front- and back-end system solution.

In June 2005, we also announced that our cumulative global shipments of satellite tuners and demodulators surpassed the 120 million unit milestone.

In August 2005, we introduced a new family of DVB decoders for mass market free-to-air (FTA) satellite STBs. The new SoC decoders offer higher levels of integration and performance, and include options for both basic and advanced functionality which allow manufacturers and broadcasters to address a wider range of markets and end-user demands. As an illustration, each device within this new family of products includes an integrated high-speed data port that easily interfaces to a variety of broadband front-ends, allowing the decoders to serve as a common back-end platform for terrestrial and cable services. This flexibility provides manufacturers with economies of scale as they can leverage a single device across multiple product offerings. According to industry analyst firm InStat, the worldwide market for FTA satellite STBs alone is projected to grow to 46 million units per year in 2009.

Convergence Video Products

In our convergence video family, our digital video encoder ICs provide a combination of features, video performance and flexibility for today s PC video, DVD and other consumer video system products. These video encoder ICs convert digital video stored on DVDs or on other digital media into the analog signals which drive both standard and high definition televisions. In addition, our line of stand-alone video decoders and integrated PCI video decoders combine worldwide video standard support, integration and software support. Our analog video decoders are designed to convert analog signals received by a set-top box, PC video system or other consumer electronic analog video device into digital streams that can be displayed by a digital video monitor or saved using a form of digital recording media.

In December 2004, we launched a new MPEG-2 audio/video (A/ V) encoder for consumer electronic products including Media Center and entertainment personal computers, television STBs, digital television sets and video recording/editing products such as DVDs and PVRs. Our new A/ V encoder builds on our existing platform and delivers improved audio and video performance for a broad range of products commonly found in today s digital home. Our new encoder accepts analog and digital video and audio in a variety of formats and encodes the input using MPEG algorithms to reduce the overall size and bandwidth of the A/V signals, enabling storage of high-quality video and audio on computers and other digital consumer electronics devices. The new encoder includes several features to ensure high-fidelity audio and superior video.

We believe our analog video decoder and A/ V decoder families provide substantial quality advances in audio and video, enabling the next generation of high-fidelity video and PC products for the digital home.

Universal and Voice Access Products

We have a long history of technological innovation and leadership in modem technology, including the development of the world s first analog modem chip. Dial-up technology, using the ordinary twisted pair copper telephone wire that connects many home and business computers to the telephone company, continues to be the world s most ubiquitous Internet connectivity option and it is a practical choice for applications where high-speed connectivity is not available or a necessity.

Our analog modem chipsets connect hundreds of millions of users worldwide to the Internet through their desktop and notebook PCs, and are also embedded in a host of products including fax machines, MFPs, POS terminals, television STBs, personal digital assistants (PDAs), and Internet appliances including Internet-connected televisions, digital picture frames, gaming consoles and web phones.

Our dial-up modem chipset offering encompasses all major industry standards established by the International Telecommunication Union (ITU) including V.22, V.22 bis, V.32 V.34, V.44, and the

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two 56 Kbps standards, V.90 and V.92. We supply mixed-signal intensive, controllerless modem chipsets and software modem solutions that take advantage of the increasing power of PC central processors and use software to perform functions traditionally enabled by semiconductor components. Data bus architectures supported include the HD audio bus, PCI bus, USB, RS-232, and audio/modem chipsets that support audio codec (AC)-Link. Building on our expertise in modem technology, we believe we are the only supplier shipping integrated modem and audio combination solutions to meet the broader needs of our customers and the industry.

In June 2005, we announced that our cumulative shipments of dial-up modems surpassed the 750 million unit milestone.

Voice over Internet protocol (VoIP) technology enables telecom carriers to move their voice services away from traditional circuit-switched networks to packet-based networks, thereby reducing operational costs and providing a lower cost alternative to traditional telephone services. Industry analyst firm IDC expects the VoIP semiconductor market to grow from $352 million in 2004 to $1.7 billion in 2008. Market drivers include increased VoIP functionality in DSL and cable modem customer premise equipment, and increased demand for IP phones and private branch exchanges (PBXs).

We have a long heritage in voice band processing and hold an extensive intellectual property portfolio in voice processing and coding technology. Our field-proven voice technology has enabled more than 100 million voice/data modems, and has been incorporated in millions of voice ports and wireless cellular telephones.

In January 2005, we introduced a new suite of voice coprocessors for consumer and small-to-medium business applications developed using our voice band processing expertise. Targeted applications include VoIP phones, analog terminal adaptors (ATAs), DSL voice routers, IADs, and multi-tenant unit/multi-dwelling unit (MTU/ MDU) voice and data systems. These coprocessors have also been specifically designed to efficiently work in conjunction with our DSL semiconductor solutions and home network processors to create comprehensive system solutions for VoIP-capable terminals. And in September 2005, we introduced the first in a family of single-chip integrated VoIP phone solutions targeted at IP- and Web-based desktop phone terminals for business and residential applications.

Future products are expected to focus on delivering modular, combination products that leverage our WLAN, video and DSL product portfolios in order to address converged voice, video, and data triple play broadband market opportunities.

Wireless Networking Products

We offer an extensive suite of WLAN solutions including 802.11a/b/g and dual-band (2.4 and 5 GHz) chipsets, firmware, software, drivers and reference designs. These wireless networking solutions are used by the world s leading telecom, networking and computer companies in a wide range of products including access points/routers, client cards, desktops, notebooks, PDAs, digital cameras, MP3 players and other hand-held networking appliances. They are available as standalone solutions or offered in conjunction with our DSL and cable modem semiconductor system solutions, VoIP chipsets and home network processors.

Our product offerings include various combinations of RF transceivers, analog base-band integrated circuits and digital base-band and medium or MAC chips and reference design guides. Many of our chipsets utilize common circuit blocks that leverage our overall product development resources and expedite our overall time to market. We offer a wide variety of wireless networking chipsets and reference designs that are enabling a new generation of wireless connectivity in notebooks, PDAs, digital cameras, MP3 players and other handheld networking appliances.

Our wireless networking products address the complementary high-growth wireless networking market by offering one of the industry s most complete lines of the 802.11 wireless products for all worldwide applications and standards. All products also adhere to and are certified by the Wi-Fi Alliance as well as other specialty certifications such as Microsoft s Windows Hardware Quality Labs, Cisco Compatible Extensions and Wi-Fi Protected Access. With the longest history of wireless development and deployment, our PRISM® technology

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has been widely utilized by industry-leading companies to enable wireless connectivity in thousands of innovative wireless networking products since 1996.

In fiscal 2005, we narrowed the market focus for our wireless networking products to include primarily: 1) embedded WLAN opportunities in cellular phones and other handheld appliances, 2) converged wireless gateway platforms including either DSL or cable as the broadband access technology and 3) yet-to-be-released 802.11n next generation technology. We believe that by limiting our focused efforts to these key areas, we enhance our opportunities to secure and defend our design positions and subsequent revenue streams by differentiating our product performance and support levels when compared to our competitors.

In May 2005, we introduced the world s lowest power and smallest form factor 802.11g WLAN radio for embedded mobile applications. The single-chip solution is a power-efficient, compact chip targeted at high performance, battery operated mobile devices such as multimedia cellular phones, enterprise handsets, PDAs, and digital cameras. This new device has been designed into several handset models by one the world s largest cellular telephone manufacturers. According to industry analyst firm InStat, shipments of Wi-Fi enabled cellular handsets are expected to reach approximately 22 million in 2009, and dual cellular/ WLAN voice handsets are expected to reach nearly 90 million for the same time period.

We have also developed physical layer (PHY) and analog front-end (AFE) products to support networking in the home. We offer a highly integrated, single-chip HomePlug semiconductor solution for Ethernet bridges, HomePlug wireless bridges and routers, and a variety of embedded applications such as media adaptors for PCs. HomePlug powerline technology uses the existing home electrical wiring to network devices such as PCs, providing Internet access and home connectivity through power outlets within the home. And because this solution was designed using our building block software platform approach, our HomePlug device can also be combined with our home network processors, DSL and cable modem solutions to allow designers to seamlessly incorporate HomePlug technology into a variety of multi-functional products.

To support the distribution of broadband content throughout the digital home, known as whole home networking, we offer products that enable personal communications devices to share data, voice, audio and video using existing telephone line, coaxial cable, power line and wireless links. We have developed a portfolio of home network processors which can be used at the core of a variety of devices, such as residential gateways, that consumers may use to access the Internet and share content using a wide range of existing and emerging connectivity technologies to link a network of home PCs and peripheral devices. In addition to connecting broadband services to networks inside the home, these processors offer processing power sufficient to implement a full-featured Statefull Packet Inspection (SPI)-based firewall. The importance of a secure firewall is greater than ever with the increasing use of always on Internet access in both the home and small office environments. The scalable system architecture of our home network processor product portfolio has also enabled digital voice terminals for voice-over-internet protocol applications, internet protocol-media terminals for video distribution, wireless data networking and other emerging connectivity applications.

Research and Development

We have significant research, development, engineering and product design capabilities. At September 30, 2005, we had approximately 1,780 employees engaged in research and development activities at multiple design centers worldwide. As part of our cost reduction initiatives, we shifted product development resources to lower cost regions during fiscal 2005. As of September 30, 2005, approximately 47% of our engineering workforce is located internationally. In particular, we have increased our engineering headcount in India from approximately 165 employees to approximately 680 employees since the end of fiscal 2004. We expect to continue our engineering headcount growth trend in the Asia-Pacific region. Our design centers provide design engineering and product application support as well as after-sales customer service. The design centers are strategically located around the world to be in close proximity to our OEM customers and to take advantage of key technical and engineering talent.

We incurred research and development expenses of $268.0 million, $240.0 million and $159.4 million in fiscal 2005, 2004 and 2003, respectively.

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Manufacturing

In 2002 we contributed our Newport Beach, California wafer fabrication operations to Jazz, a joint venture in which we hold a minority ownership, and we contributed our Newbury Park, California gallium arsenide wafer fabrication facility to Washington as part of the Skyworks Spin. These transactions completed our transition to a fully fabless business model.

Under our fabless business model, we no longer operate wafer fabrication facilities (known as foundries or fabs) and we use third parties for wafer fabrication services. Our primary wafer fabrication subcontractors include Taiwan Semiconductor Manufacturing Corporation (TSMC), United Microelectronics Corporation (UMC), Jazz, Chartered Semiconductor Manufacturing (Chartered), and International Business Machines Corporation (IBM). We use complementary metal-oxide semiconductor (CMOS) process technology for the majority of our products. We also use bipolar and bipolar CMOS (BiCMOS) process technology for certain mixed-signal devices and Silicon Germanium (SiGe) for RF tuners and wireless transceivers. Our products are currently fabricated with .5 micron, .35 micron, .25 micron, .18 micron, .15 micron and .13 micron geometry processes. We continuously evaluate the benefits, on a product by product basis, of migrating to smaller geometry processes and expect to migrate certain of our products to 90 nanometer geometry processes in the near future. We do not have any long-term wafer supply arrangements.

Our wafer probe testing is conducted by either our wafer fabrication subcontractors or other independent wafer probe test subcontractors. Following completion of the wafer probe tests, the dies are assembled into packages and the finished products are tested by subcontractors. Our primary wafer assembly and test subcontractors include Amkor Technology, Advanced Semiconductor Engineering, Inc. (ASE), and STAT SChipPAC Ltd. These vendors are located in Taiwan, Korea, Singapore, China, the Phillipines and Malaysia.

Social and Environmental Responsibility

We share the global concerns about the impact of our products on our environment and the working conditions under which they are manufactured. We are committed to ensuring that working conditions are safe, our employees are treated with respect and dignity, and that manufacturing processes are environmentally responsible. We have an internal team to develop a plan to address and demonstrate our commitment to these issues. The team recommended and we adopted three key industry standards to demonstrate our corporate commitment to these global initiatives: the International Organization for Standardization (ISO) 14001, Occupational Health and Safety Assessment Series (OHSAS) 18001 and Electronic Industry Code of Conduct (EICC). Our goal is to achieve and maintain compliance to these standards.

Environmental management presents a unique challenge to us and other fabless semiconductor companies because we do not directly manufacture semiconductor products and we rely on third party wafer fabrication, assembly, test and packaging suppliers. Our approach addresses both work performed both internally by the company and by our suppliers.

We sought and achieved certification of our environmental management system with ISO 14001-2004 for our Newport Beach and San Diego, California sites and have plans to expand this certification to Red Bank, New Jersey and Palm Bay, Florida during the 2006 calendar year. We expect to further expand this compliance to our India operations beginning in 2006 and achieve certification of all of our key sites in 2007.

All of our key suppliers confirm annually that they are compliant with ISO 14001 and OHSAS 18001 standards.

We also support the worldwide Lead (Pb)-free, Restriction of Hazardous Substances (RoHS) and Waste Electrical and Electronic Equipment (WEEE) environmental initiatives and conform to industry standard practices wherever practical. We will continue to qualify and provide Pb-free and RoHS compliant products to our customers.

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Our implementation of OHSAS and EICC is in its formative stages. However, many of our business processes are already compliant with these standards. We expect to begin self certifying to these standards for selected sites by the end of calendar year 2006.

Quality and Reliability

Our quality and reliability assurance (Q&RA) systems are designed to ensure that our products meet our customer s and our internal product performance goals. Our quality management system achieved ISO 9001-2000 certification at our Newport Beach, San Diego, Red Bank and Noida, India facilities and our Reliability Assurance system follows the appropriate Solid State Technology Association, formerly known as the Joint Electron Device Engineering Council (JEDEC), requirements to qualify our products.

Each business unit exercises extensive control during the definition, development and release to production of new products. We established a comprehensive set of design control procedures that: a) determines the quality, reliability and performance objectives for new products, b) provides program/project management, resource identification and facilities; c) ensures verification and validation activities; d) provides criteria for acceptability; and, d) clearly defines records that are necessary to provide confidence of conformity of the processes and resulting product.

We qualify all key suppliers and their manufacturing processes. Our key suppliers must agree to our quality system requirements, pass a quality management system audit, and successfully complete a rigorous reliability test plan (wafer foundries and assembly subcontractors). We design these qualification requirements as preventive actions to eliminate the causes and occurrence of potential nonconformities. These qualification requirements, reliability test plans, and quality system audits are appropriate to the impact of the potential problems.

Our qualified wafer foundries and assembly subcontractors are required to maintain their quality system compliant with ISO 9001:2000, environmental management system compliant with ISO 14001:1996 and their occupational, health and safety management system compliant with OHSAS 18001:1999. These suppliers demonstrate these compliances by having their systems registered with and audited by a third party audit agency accredited internationally by the Registrar Accreditation Board.

Customers, Marketing and Sales

We market and sell our semiconductor products and system solutions directly to leading 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 resellers accounted for approximately 28% of our fiscal 2005 net revenues. In fiscal 2005, no customer accounted for 10% or more of our net revenues. Our top 20 customers, which include distributors, accounted for approximately 64% of our fiscal 2005 net revenues.

Revenues derived from customers located in the Americas, the Asia-Pacific region and Europe were 12%, 80% and 8%, respectively, of our net revenues in fiscal 2005. 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. See Note 17 of Notes to Consolidated Financial Statements.

We have a worldwide sales and marketing organization comprised of approximately 365 employees as of September 30, 2005 in various domestic and international locations. To complement our direct sales and customer support efforts, we also sell our products through independent manufacturers representatives, distributors and dealers. In addition, our design and applications engineering staff is actively involved with customers during all phases of design and production and provides customer support through our worldwide sales offices, which are generally in close proximity to customers facilities.

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Backlog

Our sales are made primarily pursuant to standard purchase orders for delivery of products, with such purchase orders officially acknowledged by us according to our own terms and conditions. Because industry practice allows customers to cancel orders with limited advance notice to us prior to shipment, we believe that backlog as of any particular date may not be indicative of our future revenue levels.

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 U.S. and international suppliers that are both larger and smaller than us in terms of resources and market share. We anticipate that additional competitors will enter our markets and expect intense price and product competition to continue.

We compete primarily with Agere Systems, Inc., Atheros Communications, Inc., Broadcom Corporation, Centillium Communications, Inc., Infineon Technologies AG, Intel Corporation, LSI Logic Corporation, Marvell Technology Group Ltd., Motorola, Inc., NEC Corporation, Philips Electronics N.V., Silicon Laboratories, Inc., STMicroelectronics N.V. and Texas Instruments Incorporated.

Intellectual Property and Proprietary Rights

We own or license a number of United States and foreign patents and patent applications related to our products, processes and technologies. We also cross-license portions of our intellectual property and are also cross-licensed under a number of intellectual property portfolios in the industry that are relevant to our technologies and products. We have filed and received federal and international trademark registrations of our Conexant trademarks. In addition, we have registered or applied to register a number of additional trademarks applicable to our products. We believe that intellectual property, including patents, patent applications, licenses and trademarks are of material importance to our business. In addition to protecting our proprietary technologies and processes, we constantly strive to strengthen and enhance our intellectual property portfolio. We use the portfolio to seek licensing opportunities, to negotiate cross-licenses with other intellectual property portfolios, to gain access to intellectual property of others and to avoid, defend against, or settle litigation. While in the aggregate our patents, patent applications, licenses and trademarks are considered important to our operations, they are not considered of such importance that the loss or termination of any one of them would materially affect our business or financial condition.

Environmental Regulation

Federal, state and local requirements relating to the discharge of substances into the environment, the disposal of hazardous wastes, and other activities affecting the environment have had, and will continue to have, an impact on our former manufacturing operations. To date, compliance with environmental requirements and resolution of environmental claims have been accomplished without material effect on our liquidity and capital resources, competitive position or financial condition. See Certain Business Risks We may be liable for penalties under environmental laws, rules and regulations, which could adversely impact our business.

We believe that any expenditures necessary for the resolution of environmental claims will not have a material adverse effect on our liquidity and capital resources, competitive position or financial condition. We cannot assess the possible effect of compliance with future requirements.

Cyclicality; Seasonality; Possible Significant Downturns

We operate in a highly cyclical industry. See Certain Business Risks We operate in the highly cyclical semiconductor industry, which is subject to significant downturns.

Sales of certain of our products are subject to seasonal fluctuation related to the increase in sales of end-user products which include our products, such as PCs, STBs, game consoles and facsimile machines, generally associated with the holiday season in December. Our sales of semiconductor products and system

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solutions used in these products generally increase beginning in August and September and continue at a higher level through the end of the calendar year. Due to the excess channel inventory that resulted from lower than expected customer demand, we did not experience this seasonal demand in fiscal 2004 or in the first quarter of fiscal 2005.

Employees

As of September 30, 2005, we had approximately 2,400 employees, of which approximately 710 are in India. Approximately 1,870 of our employees are engineers. None of our employees are covered by collective bargaining agreements. We believe our future success will depend in large part upon our continued ability to attract, motivate, develop and retain highly skilled and dedicated employees.

Certain Business Risks

Our business, financial condition and operating results can be impacted by a number of 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.

References in this section to Conexant s fiscal year refer to the fiscal year ending on the Friday nearest September 30 of each year.

We have incurred substantial losses and we anticipate additional future losses.

Our net revenues for fiscal 2005 and 2004 were $722.7 million and $901.9 million, respectively. Our net losses for fiscal 2005 and 2004 were $176.0 million and $544.6 million, respectively.

We have implemented a number of expense reduction and restructuring initiatives to improve our operating cost structure. The cost reduction initiatives included workforce reductions, the closure or consolidation of certain facilities and an increasing shift of product development resources to lower-cost regions, among other actions. However, these expense reduction initiatives alone will not return us to profitability. In order to return to profitability, we must achieve substantial revenue growth. We cannot assure you as to whether or when we will return to profitability or whether we will be able to sustain such profitability, if achieved. In addition, our future results will be negatively affected by the implementation of new accounting rules related to the expensing of stock options commencing in the first quarter of fiscal 2006.

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

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, working capital and other financing requirements, including the current portion of our convertible debt, for at least the next twelve months. However, we cannot assure you that this will be the case and we may need to obtain alternate sources of financing in the future. At September 30, 2005, we have $711.8 million aggregate principal amount of convertible subordinated notes outstanding, of which $196.8 million is due in May 2006 and $515.0 million is due in February 2007. The conversion prices of the notes are currently substantially in excess of the market value of our common stock. At September 30, 2005, we have cash, cash equivalents and marketable securities of $380.5 million. If we are unable to generate sufficient cash flows from our operations and realize additional value from our investments and other assets, we may be unable to meet our February 2007 debt obligations without additional financing. We cannot assure you that we will have access to additional sources of capital, or be able to refinance our debt, on favorable terms or at all. In periods of a depressed stock price, raising capital through the equity markets would have a greater effect on shareholder dilution.

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Included in our cash, cash equivalents and marketable securities of $380.5 million as of September 30, 2005 are 6.2 million shares of common stock of Skyworks Solutions, Inc. valued at $43.4 million. For this equity security holding, there is risk associated with the overall state of the stock market, having available buyers for the shares we sell, and ultimately being able to liquidate the securities at a favorable price. We cannot assure you that the carrying value of these assets will ultimately be realized.

In addition, any strategic investments and acquisitions that we may desire to make to help us grow our business 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 operate in the highly cyclical semiconductor industry, which is subject to significant downturns.

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 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.

Demand for our products in each of the communications electronics end-markets which we address is subject to a unique set of factors, and a downturn in demand affecting one market may be more pronounced, or last longer, than a downturn affecting another of our markets.

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 our revenues, earnings and other operating results 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;

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.

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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 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.

We cannot assure you that we will be able to successfully address these factors.

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.

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 represented approximately 64% and 59% of our net revenue in fiscal 2005 and 2004, 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

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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.

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 into India and China.

As a result of the Paxonet Communications acquisition in December 2004 and organic growth, we have increased our headcount in India from approximately 180 employees to approximately 710 employees at several design centers since the end of fiscal 2004. We plan to continue this growth trend in India and other international locations 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 cannot assure you that we will 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.

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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.

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:

issuances of equity securities dilutive to our existing shareholders;

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.

Additionally, 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 charge against earnings. At September 30, 2005, we have $717.0 million of goodwill, of which approximately $625.2 million was generated in the Merger. When market capitalization is below book value, it is an indicator that goodwill may be impaired. Our market capitalization has been below book value in the past but was above our book value at September 30, 2005. We performed our annual evaluation of goodwill and have determined that no impairment was required. However, if our market capitalization drops below our book value for a prolonged period of time, or our current assumptions regarding our future operating performance changes, we may be required to write down the value of our goodwill by taking a non-cash charge against earnings.

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.

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; and

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

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 are subject to the risks of doing business internationally.

For fiscal 2005 and 2004, approximately 90% and 91%, respectively, of our net revenues were from customers located outside of the United States, primarily in the Asia-Pacific region and Europe. In addition, a significant portion of our workforce, including approximately 710 employees in India, and many of our key suppliers are located outside 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;

tax laws, including the cost of services provided and products sold between Conexant and its 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. We cannot assure you that the factors described above will not have a material adverse effect on our ability to increase or maintain our foreign sales.

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 28% and 36% of our net revenues for fiscal 2005 and 2004, respectively. Our arrangements with these distributors are terminable at any time, and therefore 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.

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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.

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 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, retain and motivate qualified personnel, including executive officers and other key management and technical personnel. 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.

We may have particular difficulty attracting and retaining key personnel during periods of poor operating performance. The loss of the services of one or more of our key personnel, including Dwight W. Decker, our Chairman of the Board and Chief Executive Officer, F. Matthew Rhodes, our President, or certain key design and technical personnel, or our inability to attract, retain and motivate qualified personnel could have a material adverse effect on our ability to operate our business.

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.

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,

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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 28% and 36% of our net revenues for fiscal 2005 and 2004, 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 the further decline of average selling prices for certain of our products resulted in net inventory charges aggregating $44.1 million.

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). 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. We do not have any long-term supply arrangements.

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 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 and increased expenses.

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 most of our products are manufactured in .35 micron, .25 micron, .18 micron, .15 micron, and .13 micron geometry processes. In addition, we expect to migrate some of our products to 90 nanometer process technology. 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 harm our relationships with our customers and 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.

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

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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;

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.

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

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 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 sued 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 sued in purported shareholder derivative actions. 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.

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 at one Superfund site located at a former silicon wafer

manufacturing facility and steel fabrication plant in Parker Ford, Pennsylvania formerly

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occupied by us. In addition, we are engaged in remediations of groundwater contamination at our former Newport Beach, California wafer fabrication facility. We currently estimate the remaining costs for these remediations to be approximately $2.7 million and have accrued for these costs as of September 30, 2005.

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 September 30, 2005, we had approximately $1.2 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 $440 million of the NOL carry forwards were acquired in the Merger and other acquisitions. The NOL carry forwards are scheduled to expire at various dates through 2025. 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:

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;

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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.

Executive Officers

Our executive officers are:

Name	Age	Position
Dwight W. Decker	55	Chairman of the Board and Chief Executive Officer
F. Matthew Rhodes	48	President
Lewis C. Brewster	41	Executive Vice President and Chief Operating Officer
J. Scott Blouin	55	Senior Vice President and Chief Financial Officer
Dennis E. O Reilly	61	Senior Vice President, Chief Legal Officer and Secretary

There are no family relationships among our directors or executive officers. Set forth below are the name, office and position held with the Company and principal occupations and employment during the past 5 years of each of our executive officers.

Dwight W. Decker Chairman of the Board and Chief Executive Officer since November 2004; non-executive Chairman of the Board from February 2004 to November 2004; and Chairman of the Board and Chief Executive Officer prior thereto. Mr. Decker received a Ph.D. in applied mathematics from the California Institute of Technology and a B.Sc. in mathematics and physics from McGill University.

F. Matthew Rhodes President since June 2003; Senior Vice President and President of our former Broadband Communications segment from May 2002 to June 2003; and Senior Vice President and General Manager, Personal Computing prior thereto. Mr. Rhodes received an M.B.A. from the Anderson Graduate School of Management of the University of California, Los Angeles, an M.S. in electrical engineering from Lehigh University and a B.S. in physics from The Pennsylvania State University.

Lewis C. Brewster Executive Vice President and Chief Operating Officer since November 2004; Executive Vice President, Sales, Operations and Quality from February 2004 to November 2004; Executive Vice President and Chief Operating Officer from June 2003 to February 2004; and Senior Vice President, Worldwide Sales prior thereto. Mr. Brewster received an M.B.A. from Stanford University and a B.S. in electrical engineering and biomedical engineering from Duke University.

J. Scott Blouin Senior Vice President and Chief Financial Officer since August 2004; Senior Vice President and Chief Accounting Officer from February 2004 to August 2004; Senior Vice President and Chief Financial Officer from June 2003 to February 2004; Senior Vice President, Chief Accounting Officer and Controller from March 2002 to June 2003; Senior Vice President and Chief Accounting Officer from January 2001 to March 2002; and Chief Financial Officer of Burr-Brown Corporation (semiconductors) from February 1996 to August 2000. Mr. Blouin received an M.B.A. from Wake Forest University and a B.S. in administration from the University of New Hampshire at Durham.

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Dennis E. O Reilly Senior Vice President, Chief Legal Officer and Secretary since February 2004; and Senior Vice President, General Counsel and Secretary prior thereto. Mr. O Reilly received a J.D. from Boston University School of Law and a B.A. from the State University of New York at Binghamton.

Available Information

We maintain an Internet website at http://www.conexant.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, along with our annual report to shareowners and other information related to our company, are available free of charge on this site as soon as reasonably practicable after we electronically file or furnish these reports with the Securities and Exchange Commission. Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Item 2. ***Properties***

Our headquarters in Newport Beach, California consists of approximately 73,000 square feet of owned space and approximately 197,000 square feet of leased space. We also have facilities in San Diego, California which consists of approximately 160,000 square feet of leased space, Red Bank, New Jersey which consists of approximately 100,000 square feet of leased space, and Palm Bay, Florida which consists of approximately 26,000 square feet of leased space.

Activities at all the above locations include administration, sales and marketing, research and development (including design centers) and operations functions.

We also own a facility in Noida, India with approximately 23,000 square feet of space and lease additional facilities in India which consist of approximately 173,000 square feet of leased space.

At September 30, 2005, we also operated in an additional 11 domestic and 17 international offices. These facilities had an aggregate of approximately 146,000 square feet of leased floor space.

As a result of our reorganization and various restructuring related activities, at September 30, 2005 we have an additional 731,000 square feet of leased space and 383,000 square feet of owned space, of which approximately 77% is being subleased or leased to third parties. We lease 380,000 square feet of owned space at our Newport Beach location to Jazz and 3,000 square feet of owned floor space at our Newport Beach facility to Skyworks. We also sublease 176,000 square feet at our Newport Beach facility to Mindspeed.

We believe our properties have been well maintained, are in sound operating condition and contain all the equipment and facilities necessary to operate at present levels. Our California facilities, including one of our design centers, are located near major earthquake fault lines. We maintain no earthquake insurance with respect to these facilities. Certain of our facilities are located in countries that may experience civil unrest.

Item 3. ***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. In June 2003, Conexant, Inc. and the named officers and directors entered into a memorandum of

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understanding outlining a settlement agreement with the plaintiffs that will, among other things, result in the dismissal with prejudice of all the claims against the former GlobeSpan, Inc. officers and directors. The final settlement was executed in June 2004. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes and granting preliminary approval of the settlement, subject to modification of certain bar orders contemplated by the settlement. The bar orders have since been modified. The settlement remains subject to a number of conditions and final approval. It is possible that the settlement will not be approved. Even if the settlement is approved, individual class members will have an opportunity to opt out of the class and to file their own lawsuits, and some may do so. In either event, we do not anticipate that the ultimate outcome of this litigation will have a material adverse impact on our financial condition, results of operations, or cash flows.

Texas Instruments, Inc. Our Conexant, Inc. subsidiary has been involved in a dispute with Texas Instruments, Inc. (Texas Instruments) and Stanford University and its Board of Trustees, and Stanford University OTL, LLC (Stanford)(and collectively, the Defendants) over a group of patents (and related foreign patents) that Texas Instruments alleges are essential to certain industry standards for implementing ADSL technology. On June 12, 2003, Conexant, Inc. filed a complaint against Texas Instruments, Stanford University and its Board of Trustees, and Stanford University OTL, LLC (collectively, the Defendants) in the U.S. District Court of New Jersey. The complaint asserts, among other things, that the Defendants have violated the antitrust laws by creating an illegal patent pool, by manipulating the patent process and by abusing the process for setting industry standards related to ADSL technology. The complaint also asserts that the Defendants patents relating to ADSL are unenforceable, invalid and/or not infringed by Conexant, Inc. products. Conexant, Inc. is seeking, among other things, (i) a finding that the Defendants have violated the federal antitrust laws and treble damages based upon such a finding, (ii) an injunction prohibiting the Defendants from engaging in anticompetitive practices, (iii) a declaratory judgment that the claims of the Defendants ADSL patents are invalid, unenforceable, void, and/or not infringed by Conexant, Inc. and (iv) an injunction prohibiting the Defendants from pursuing patent litigation against Conexant, Inc. and its customers. On August 11, 2003 and September 9, 2003, the Defendants answered the complaint, denied Conexant, Inc. s claims and filed counterclaims alleging that Conexant, Inc. has infringed certain of their ADSL patents. In addition to other relief, the Defendants are seeking to collect damages for alleged past infringement and to enjoin Conexant, Inc. from continuing to use the Defendant s ADSL patents. The case has been bifurcated into a patent module and an antitrust module, with the patent module being tried first. Trial on the patent module will commence on January 4, 2006 in the U.S. District Court of New Jersey. Although we believe that Conexant, Inc. has strong arguments in favor of its position in this dispute, we can give no assurance that Conexant, Inc. will prevail on any of these grounds in litigation. If any such litigation is adversely resolved, Conexant, Inc. could be held responsible for the payment of damages and/or future royalties and/or have the sale of certain of Conexant, Inc. products stopped by an injunction, any of which could have a material adverse effect on our business, financial condition and results of operations.

Class Action Suits. In December 2004 and January 2005, the Company and certain current and former officers were named as defendants in several complaints seeking monetary damages filed on behalf of all persons who purchased Company 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 (the Exchange Act) by allegedly disseminating materially false and misleading statements and/or concealing material adverse facts. The California cases have now been consolidated with the New Jersey cases so that all of the class action suits, now known as *Witriol v. Conexant, et al.*, are being heard in the U.S. District Court of New Jersey by the same judge. The defendants believe these charges are without merit and intend to vigorously defend the litigation. On September 1, 2005, the defendants filed their motion to dismiss the case. On November 23, 2005, the court granted the plaintiff s motion to file a Second Amended Complaint, which was filed on December 5, 2005. Thereafter, the defendants plan to file a motion to dismiss the case, which motion will be due by February 6, 2006.

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

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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 seeking monetary damages 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 defendants believe these charges are without merit and intend to vigorously defend the litigation. The plaintiff filed an Amended Complaint on August 11, 2005. On October 12, 2005, the defendants filed a motion to dismiss this case.

Shareholder Derivative Suits. In January 2005, the Company and certain current and former directors and officers were named as defendants in purported shareholder derivative actions seeking monetary damages (now consolidated) in 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 U.S. District Court of New Jersey in May 2005. On July 28, 2005, the California court approved a stay of the action filed in California pending the outcome of the motion to dismiss in *Witriol v. Conexant, et al.* The Company has negotiated a similar agreement with the plaintiffs in the New Jersey case, which has also been approved by the New Jersey court. Pursuant to the stay agreements, in the event that the parties in the *Witriol* case engage in any negotiations, plaintiffs counsel in the derivative cases will be kept informed. The defendants believe the charges in theses cases are without merit and intend to vigorously defend the litigation.

Various other lawsuits, claims and proceedings have been or may be instituted or asserted against us or our subsidiaries, including those pertaining to product liability, intellectual property, environmental, safety and health, and employment matters. The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to 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 financial condition or results of operations of the Company.

Item 4. ***Submission of Matters to Vote of Security Holders***

No matters were submitted to a vote of our shareholders during the quarter ended September 30, 2005.

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock is traded on the Nasdaq National Market under the symbol CNXT . The following table lists the high and low per share sale prices for our common stock as reported by the Nasdaq National Market for the periods indicated:

	High	Low
Fiscal year ended September 30, 2005:		
First quarter	$ 2.23	$ 1.50
Second quarter	2.05	1.36
Third quarter	1.75	0.95
Fourth quarter	2.17	1.57
Fiscal year ended September 30, 2004:		
First quarter	$ 6.42	$ 4.64
Second quarter	7.85	5.16
Third quarter	6.70	3.72
Fourth quarter	2.65	1.37

At November 25, 2005, there were approximately 42,241 holders of record of our common stock.

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We have never paid cash dividends on our capital stock. We currently intend to retain any earnings for use in our business and to repay our indebtedness, and do not anticipate paying cash dividends in the foreseeable future.

Item 6. ***Selected Financial Data***

The following selected financial data for the five years ended September 30, 2005 was derived from the audited consolidated financial statements of Conexant and its subsidiaries. In June 2002, Conexant completed the spin-off of its wireless communications business and the sale of its Mexicali Operations, and in June 2003, Conexant completed the spin-off of its Mindspeed Technologies Internet infrastructure business. The selected financial data for all periods have been restated to reflect these businesses as discontinued operations. In February 2004, Conexant completed the merger with GlobespanVirata, Inc. The results of GlobespanVirata, Inc. have been included in the consolidated results since February 28, 2004.

The selected financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto appearing elsewhere in this report.

	2005	2004	2003	2002	2001
	(In thousands, except per share amounts)				
Net revenues	$ 722,739	$ 901,854	$ 599,977	$ 521,726	$ 541,688
Cost of goods sold	493,973	523,129	338,161	317,921	522,560
Gross margin	228,766	378,725	261,816	203,805	19,128
Operating expenses:					
Research and development	267,996	239,971	159,354	156,350	175,026
Selling, general and administrative	117,861	125,474	93,426	95,750	141,276
Amortization of intangible assets	32,322	20,769	3,437	19,489	19,814
In-process research and development(1)		160,818			
Special charges(2)	45,977	32,801	18,379	30,499	369,258
Total operating expenses	464,156	579,833	274,596	302,088	705,374
Operating loss	(235,390)	(201,108)	(12,780)	(98,283)	(686,246)
Debt conversion costs				10,435	42,584
Gain on extinguishment of debt			(42,021)		(11,710)
Interest expense	33,691	30,708	28,120	31,069	33,597
Other (income) expense, net(3)	(95,413)	69,100	(22,312)	5,801	(34,434)
Income (loss) before income taxes	(173,668)	(300,916)	23,433	(145,588)	(716,283)
Provision (benefit) for income taxes(1)	2,322	243,733	(129)	(1,838)	(55,373)
Income (loss) from continuing operations	(175,990)	(544,649)	23,562	(143,750)	(660,910)

Loss from discontinued operations(4)			(728,877)	(737,017)	(784,424)
Net loss	$ (175,990)	$ (544,649)	$ (705,315)	$ (880,767)	$ (1,445,334)
Income (loss) from continuing operations per share:					
Basic	$ (0.37)	$ (1.40)	$ 0.09	$ (0.56)	$ (2.70)
Diluted	(0.37)	(1.40)	0.09	(0.56)	(2.70)

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	2005	2004	2003	2002	2001
	(In thousands, except per share amounts)				
Balance Sheet Data					
Working capital	$ 125,856	$ 434,802	$ 233,017	$ 443,948	$ 444,974
Total assets	1,581,524	1,880,522	931,707	1,911,035	2,815,480
Current portion of convertible subordinated notes	196,825				
Long-term obligations	599,007	780,708	643,260	743,523	761,927
Shareholders equity	569,093	828,387	166,766	947,827	1,773,176

(1) In fiscal 2004, we recorded $160.8 million of in-process research and development expenses related to the Merger and a $255.7 million charge for the impairment of deferred tax assets.

(2) See Note 15 of Notes to Consolidated Financial Statements for components of special charges. In fiscal 2001, we recorded special charges of $369.3 million, principally related to the impairment of certain manufacturing assets and restructuring activities.

(3) See Note 7 of Notes to Consolidated Financial Statements for components of other (income) expense, net.

(4) Loss from discontinued operations (net of income taxes) for all periods represents the operating results of our former wireless communications business and our Mexicali Operations which we disposed of in June 2002 and the Mindspeed Technologies Internet infrastructure business which we disposed of in June 2003.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Except where otherwise noted, this discussion of our financial condition and results of operations represents our continuing operations, excluding our discontinued Mindspeed Technologies business which we disposed of in June 2003, and including the GlobespanVirata, Inc. business from February 28, 2004, following completion of our merger with GlobespanVirata, Inc. (the Merger).

Merger with GlobespanVirata

On February 27, 2004, we completed the Merger with GlobespanVirata, Inc., or GlobespanVirata, a provider of broadband communications solutions for consumer, enterprise and service provider markets. In May 2004, GlobespanVirata was renamed Conexant, Inc. See Note 2 of Notes to Consolidated Financial Statements for further information.

Spin-off of Mindspeed Technologies Business

On June 27, 2003, we completed the distribution to Conexant shareholders of all outstanding shares of Mindspeed, our wholly owned subsidiary, to which we contributed our Internet infrastructure business, including the stock of certain subsidiaries, and certain other assets and liabilities, including $100.0 million in cash (the Mindspeed Spin). In the Mindspeed Spin, Conexant shareholders received one share of Mindspeed common stock for every three Conexant shares held and the Conexant shareholders continued to hold their Conexant shares. Mindspeed issued to us a warrant to purchase 30 million shares of Mindspeed common stock, representing approximately 20 percent of Mindspeed s outstanding common stock on a fully diluted basis. The warrant is exercisable until June 27, 2013 at an exercise price of $3.408 per share. The fair value of the warrant is presented as an asset on our consolidated balance sheet. Additionally, we entered into a senior secured revolving credit facility pursuant to which Mindspeed could have borrowed up to $50.0 million for working capital and general corporate purposes. On December 8, 2004, the Mindspeed credit facility was terminated (see Note 11 of Notes to Consolidated Financial Statements).

Business Enterprise Segments

We operate in one reportable operating segment, broadband communications. Statement of Financial Accounting Standards No. 131 (SFAS No. 131), Disclosures about Segments of an Enterprise and Related

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Information , establishes standards for the way that public business enterprises report information about operating segments in annual consolidated financial statements. Although we had four operating segments at September 30, 2005, under the aggregation criteria set forth in SFAS No. 131, we only operate in one reportable operating 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.

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

the sale of 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 operating segment.

Net revenues by our product lines are as follows (in millions):

	2005	2004	2003
Broadband Access Products	$ 192.0	$ 254.6	$ 64.3
Broadband Media Processing Products	155.4	214.2	165.5
Universal and Voice Access Products	289.2	323.1	325.2
Wireless Networking Products and other	86.1	110.0	45.0
	$ 722.7	$ 901.9	$ 600.0

Overview of 2005 Financial Performance

Our net revenues for fiscal 2005 and 2004 were $722.7 million and $901.9 million, respectively, which represents a decrease of $179.2 million or 20%. This decrease resulted from an annual average selling price (ASP) erosion of approximately 24% which was only slightly offset by a year over year volume increase of approximately 4%. The ASP erosion was most significant in our Broadband Access and Wireless Networking businesses. The year over year volume increase would have been much larger if we had not experienced a decrease in demand for our products in the first half of fiscal 2005 as a result of the excess channel inventory build-up more fully described below. We also had less demand for our Wireless Networking products as a result of a loss of market share in the latter part of fiscal 2004.

Our quarterly revenues increased sequentially each quarter during fiscal 2005. In the first quarter of fiscal 2005, our net revenues were $140.6 million or a 34% decline from the fourth quarter of fiscal 2004 revenues of $213.1 million. The decline in revenues from the fourth quarter of fiscal 2004 to the first quarter of fiscal 2005 was the result of lower than expected end-customer demand during fiscal 2004 which resulted in approximately

$70.0 million of excess channel inventory build-up at our direct customers, distributors and resellers and lower net revenues in our Broadband Access business as a result of ASP erosion. Channel inventory was reduced by approximately $50.0 million in the first fiscal quarter of 2005 and by an additional $20.0 million in the second quarter of fiscal 2005. We experienced increased demand throughout fiscal 2005 as a result of the

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decrease in channel inventory build-up which occurred early in the fiscal year and other increases in demand for our products. In the fourth quarter of fiscal 2005, we recorded net revenues of $214.9 million or a 53% increase over our first quarter of fiscal 2005 revenues. We expect our fiscal 2006 net revenues to increase over our fiscal 2005 net revenues as a result of the channel inventory reduction that we experienced in early fiscal 2005 and increased demand for our products, in particular STB products within our Broadband Media business.

We have implemented a number of cost reduction initiatives since the time of the Merger. Most of these actions were completed by the end of fiscal 2005. The cost savings of these actions will be fully reflected in our results for the first quarter of fiscal 2006. Our research and development and selling general and administrative expenses declined by $21.5 million or 20% from $108.5 million in the fourth quarter of fiscal 2004 to $87.0 million in the fourth quarter of fiscal 2005. This reduction in expenses primarily reflects our shift of product development resources to lower cost regions and selling, general and administrative function consolidation. We continuously evaluate our business in light of current market and competitive conditions and to ensure that our operating expenses are in line with our expected revenue forecasts. As a result, future periods may require further actions to reduce operating expenses. We do not believe that these actions have or will inhibit our ability to invest in appropriate levels of research and development.

We expect our research and development and selling, general and administrative operating expenses to increase from the fourth quarter of fiscal 2005 levels as a result of the impact of stock option expense charges under SFAS 123(R) commencing in the first quarter of fiscal 2006 and increased incentive based performance and compensation costs.

Results of Operations

Net Revenues

	2005	Change	2004	Change	2003
(In millions)					
Net revenues	$ 722.7	(20)%	$ 901.9	50%	$ 600.0

We recognize revenue when (i) the risk of loss has been transferred to the customer, (ii) price and terms are fixed, (iii) no significant vendor obligation exists, and (iv) 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 a contractual right of return or for which the contractual terms were not enforced. Revenue with respect to these distributors is deferred until the purchased products are sold through by the distributor to a third party. Other 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 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 of the periods presented.

Conexant has many distributor customers for whom revenue is recognized upon shipment of its product to them, as the contractual terms provide for no or limited rights of return. During the three months ended December 31, 2004, we determined that we were unable to enforce our contractual terms with three distribution customers. As a result, from October 1, 2004, we have deferred the recognition of revenue on sales to these three distributors until the purchased products are sold by the distributors to a third party. At September 30, 2005, deferred revenue for these three distributors was $6.5 million.

See Overview of 2005 Financial Performance above for a discussion of net revenues for fiscal 2005.

Our net revenues for fiscal 2004 increased 50% over fiscal 2003. The increase is primarily associated with increased unit shipments of our Broadband Access and Wireless Networking products associated with the Merger, and to a lesser extent the increase in sales of satellite set-top box solutions, and convergence video products using MPEG codec technology. Partially offsetting the increase in revenues from increased unit shipments is the erosion of average selling prices beginning in the fourth quarter of fiscal 2004 due to

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(i) unfavorable product mix as newer, higher margin products experienced slower than expected growth in the latter portion of fiscal 2004 and (ii) intense competition in certain of our product lines.

Gross Margin

	2005	Change	2004	Change	2003
(In millions)					
Gross margin	$ 228.8	(40)%	$ 378.7	45%	$ 261.8
Percent of net revenues	32%		42%		44%

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

Our gross margin for fiscal 2005 was 32% compared to the fiscal 2004 gross margin of 42%. The gross margin percentage decrease from fiscal 2004 is attributable to the effects of (i) net inventory charges of $44.1 million, and (ii) a 24% decrease in ASPs which were partially offset by lower inventory costs. Contributing to the 24% ASP decline was the re-establishment of $17.1 million of net revenue reserves, which we maintain to estimate customer pricing adjustments, and were depleted as a result of special pricing given to select customers to facilitate the reduction of channel inventory during fiscal 2005. We expect that our gross margin percentage will increase in future periods as compared to our gross margin percentage for the fourth quarter of fiscal 2005 of 40.3% as a result of product cost reduction programs that are expected to exceed price erosion.

Gross margin percentage decreased from 44% in 2003 to 42% in 2004. This decrease resulted from the effects of revenues in fiscal 2003 for products that we had written down to zero cost basis during fiscal 2001.

Our gross margin for fiscal 2003 benefited from the sale of inventories with an original cost of $10.9 million that we had written down to a zero cost basis during fiscal year 2001. These sales resulted from renewed demand for certain products that was not anticipated at the time of the write-downs. The previously written-down inventories were generally sold at prices which exceeded their original cost. Had we not previously written down the cost basis of these goods, our cost of goods sold would include the original cost of these items, and our gross margin for 2003 would have been $250.9 million (42% of our net revenues).

We assess the recoverability of our inventories at least quarterly through a review of inventory levels in relation to foreseeable demand, generally over nine to 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 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 year ended September 30, 2005, we recorded $35.9 million in inventory charges for excess and obsolete (E&O) inventory primarily as a result of the reduced demand outlook for fiscal year 2005 related to Broadband Access and Wireless

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Networking products. Activity in our E&O inventory reserves for the years ended September 30, 2005 and 2004 was as follows (in thousands):

	2005	2004
E&O reserves, beginning of period	$ 23,319	$ 25,177
Additions	35,944	11,586
Release upon sales of product	(5,864)	(7,123)
Scrap	(11,319)	(3,792)
Standards adjustments and other	2,753	(2,529)
E&O reserves, end of period	$ 44,833	$ 23,319

We have created an action plan at a product line level to scrap approximately 25% of the E&O products and we are still in the process of evaluating the remaining reserved 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 years ended September 30, 2005 and 2004, we sold $5.9 million and $7.1 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.

Further, on a quarterly basis, we assess the net realizable value of our inventories. When the estimated average selling price, plus costs to sell our inventory falls below our inventory cost, we adjust our inventory to its current estimated market value. During the year ended September 30, 2005, we recorded $20.2 million in inventory charges to adjust certain Wireless Networking products to their estimated market value. Increases to this inventory reserve may be required based upon actual average selling prices and changes to our current estimates, which would impact our gross margin percentage in future periods. Activity in our lower of cost or market (LCM) inventory reserves for the year ended September 30, 2005 was as follows (in thousands). There were no LCM reserves in fiscal 2004.

	2005
LCM reserves, beginning of period	$
Additions	20,179
Release upon sales of product	(6,175)
Standards adjustments and other	(7,265)
LCM reserves, end of period	$ 6,739

Research and Development

	2005	Change	2004	Change	2003

(In millions)					
Research and development	$ 268.0	12%	$ 240.0	51%	$ 159.4
Percent of net revenues	37%		27%		27%

Our research and development (R&D) expenses consist principally of direct personnel costs to develop new communications and semiconductor products, allocated direct 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

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R&D expenses also include the costs for design automation and advanced package development, and non-cash stock compensation charges related to the amortization of unvested stock options exchanged in the Merger and other acquisitions.

The $28.0 million increase in R&D expenses for fiscal 2005 compared to fiscal 2004 primarily reflects additional development costs associated with DSL and Wireless products as a result of the timing of the Merger (seven months of expenses in fiscal 2004 compared to twelve months in fiscal 2005) and an increase of $3.7 million in stock compensation charges as a result of the Merger. These increases were partially offset by the shift of product development resources to lower cost regions during fiscal 2005. As a result of the impact of stock option expense charges under SFAS No. 123(R) commencing in the first quarter of fiscal 2006 and increased incentive based performance and compensation costs, we expect quarterly R&D expenses to increase in future periods.

The $80.6 million increase in R&D expenses for fiscal 2004 compared to fiscal 2003 primarily reflects additional development costs associated with DSL and Wireless products as a result of the Merger, an increase of $4.9 million in stock compensation charges primarily as a result of the Merger, and to a much lesser extent, increased R&D project costs associated with purchased R&D and electronic design automation tools.

Selling, General and Administrative

	2005	Change	2004	Change	2003
(In millions)					
Selling, general and administrative	$ 117.9	(6)%	$ 125.5	34%	$ 93.4
Percent of net revenues	16%		14%		16%

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 other services, and non-cash stock compensation charges related to the amortization of unvested stock options exchanged in the Merger and other acquisitions.

The $7.6 million decrease in SG&A expense for fiscal 2005 compared to fiscal 2004 is attributable to a $6.1 million reduction of accounts receivable bad debt expense as a result of improved collections experience, a $1.3 million refund of previously remitted sales taxes, and $1.4 million of other net decreases primarily related to our cost reduction programs associated with the Merger, offset by additional expenses associated with the timing of the Merger (including a $1.2 million increase in stock compensation charges). We expect that fiscal 2006 SG&A expenses will be approximately flat with fiscal 2005 levels as a result of additional expenses from the implementation of SFAS No. 123(R) commencing in the first quarter of fiscal 2006 and increased incentive based performance and compensation costs, which are expected to offset the savings generated by our cost reduction programs which were implemented in fiscal 2005.

The $32.1 million increase in SG&A expense for fiscal 2004 compared to fiscal 2003 is attributable to additional SG&A costs as a result of the Merger in February 2004, an increase of $1.8 million in stock compensation charges as a result of the Merger, and $4.5 million in additional bad debt reserves, partially offset by $1.3 million in stock compensation benefits associated with an employee bonus plan in prior years which had variable accounting.

Amortization of Intangible Assets

	2005	2004	2003
(In millions)			
Amortization of intangible assets	$ 32.3	$ 20.8	$ 3.4

Amortization expense is recorded for intangible assets other than goodwill pursuant to SFAS Nos. 141 and 142. SFAS No. 141 requires that all business combinations be accounted for using the purchase method

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and provides criteria for recording intangible assets separately from goodwill. Goodwill must be tested at least annually for impairment and written down when impaired.

Amortization expense of $32.3 million in fiscal 2005 increased by $11.5 million over the $20.8 million recorded in fiscal 2004. This increase is attributable to the significant intangible assets we acquired in the Merger. Amortization expense of $20.8 million in fiscal 2004 increased by $17.4 million over the $3.4 million recorded in fiscal 2003. This increase is attributable to the significant intangible assets we acquired in the Merger. See Note 2 of Notes to Consolidated Financial Statements.

In-Process Research and Development

The in-process research and development (IPR&D) charge of $160.8 million in fiscal 2004 is related to the Merger completed on February 27, 2004. See Note 2 of Notes to Consolidated Financial Statements for a discussion of the IPR&D charge.

Special Charges

Special charges consist of the following:

	2005	2004	2003
(In millions)			
Asset impairments	$ 3.8	$ 5.4	$ 9.6
Restructuring charges	28.0	9.3	5.2
Integration costs	7.7	7.3	
Other	6.5	10.8	3.6
	$ 46.0	$ 32.8	$ 18.4

See Note 15 of Notes to Consolidated Financial Statements for a discussion of asset impairment charges, restructuring charges, integration costs and other special charges.

Gain on Extinguishment of Debt

During fiscal 2003, we purchased $100.0 million principal amount of our 4% Convertible Subordinated Notes due 2007 at prevailing market prices, resulting in a net gain of $42.0 million.

Interest Expense

	2005	2004	2003
(In millions)			
Interest expense	$ 33.7	$ 30.7	$ 28.1

Interest expense is primarily related to our convertible subordinated notes. See Note 9 of Notes to Consolidated Financial Statements for further description of the notes.

As a result of the acquisition of $130.0 million of the 5.25% convertible subordinated notes of Conexant, Inc. in the Merger, interest expense for fiscal 2005 was higher than fiscal 2004. As $196.8 million of our convertible subordinated notes are due in May 2006, and notwithstanding any changes in our long-term debt arrangements, we expect interest expense to be lower in fiscal 2006 as compared to fiscal 2005.

Other (Income) Expense, Net

	2005	2004	2003
(In millions)			

Other (income) expense, net	$ (95.4)	$ 69.1	$ (22.3)

Other (income) expense, net for fiscal 2005 was primarily comprised of $91.3 million of gains on sales of equity securities (primarily our investment in SiRF Technologies Holdings, Inc. or SiRF), a $7.1 million

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increase in the fair value of the Mindspeed warrant, $6.5 million of investment and interest income on invested cash balances, offset by $10.6 million of losses in our equity method investees. Due to variations in the fair value of the common stock underlying the Mindspeed warrant, we expect that other (income) expense, net may fluctuate significantly in future periods until this derivative instrument is liquidated or expires.

Other (income) expense, net for fiscal 2004 was comprised of a $13.4 million write-down of certain non-marketable investments, a $6.3 million decrease in the fair value of the conversion right under the Skyworks 15% convertible senior subordinated note prior to its conversion into Skyworks common stock in May 2004, and a $92.7 million decrease in the fair value of the Mindspeed warrant, offset by $7.7 million of investment and interest income on invested cash balances, $14.4 million of income in our equity method investees, and $24.1 million of gains on sales of investments (primarily our investment in SiRF).

Other (income) expense, net for fiscal 2003 was comprised of a $30.2 million increase in the fair value of the Mindspeed warrant, a $9.4 million increase in the fair value of the conversion right under the Skyworks 15% convertible senior subordinated notes, $8.6 million of gains on sales of investments and $15.6 million of investment income and interest income on invested cash balances, offset by a $39.4 million write-down of certain non-marketable investments, and $3.1 million of losses in our equity method investments.

The carrying values of certain non-marketable investments were written down to their estimated fair values (in most cases, zero). These investments consist of equity interests in early stage technology companies which we had accounted for under the cost method. We estimated the fair value of these investments based upon available financial and other information, including the then-current and projected business prospects for the subject companies, and determined that the decline in the fair value of these investments was other than temporary.

Provision (Benefit) for Income Taxes

In fiscal 2005, we recorded an income tax provision of $2.3 million primarily reflecting income taxes imposed on our foreign subsidiaries. No federal income tax expense was recorded for fiscal 2005 due to our net losses for the period. Except to the extent of the federal alternative minimum tax (AMT), we expect this will continue for the foreseeable future. We do not expect to recognize any income tax benefits relating to future operating losses until we believe that such tax benefits are more likely than not to be realized. Under the AMT system, a current year deduction is somewhat more beneficial than utilization of a net operating loss (NOL). During fiscal 2005, to reduce our future expected AMT, we amended certain prior year tax returns and elected to capitalize and amortize over 10 years $581.0 million of R&D expenses that were treated as current year deductions on the returns previously filed. These amended returns reduced the $1.75 billion of NOLs previously reported. This adjustment was made for tax reporting purposes and had no impact on the accompanying financial statements.

In fiscal 2004, we recorded an income tax provision of $243.7 million. This provision is comprised of an increase in the valuation allowance on deferred tax assets of $255.7 million and a current provision of $2.0 million primarily reflecting income taxes imposed on our foreign subsidiaries, partially offset by a $14.0 million credit related to a federal income tax refund received in September 2004 related to the carryback of a portion of our fiscal year 2001 net operating loss. The loss was carried back under the five-year carryback provision enacted in 2002 and income taxes paid while Conexant was a subsidiary of Rockwell Automation, Inc. were recovered.

In fiscal 2004, as a result of our cumulative operating losses, we determined that it is more likely than not that the additional income tax benefits (principally net operating losses we can carry forward to future years) will not be realized. Accordingly, we increased our valuation allowance by approximately $255.7 million during fiscal 2004 for the deferred tax assets which we do not expect to realize through the reduction of future income tax payments. See Note 8 of Notes to Consolidated Financial Statements for further information. We do not expect to recognize any income tax benefits relating to future operating losses until we believe that such tax benefits are more likely than not to be realized. While we will continue to be subject to foreign income taxes and federal alternative minimum tax, we expect those taxes will be insignificant.

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As of September 30, 2005, we had $1.2 billion of fully reserved deferred tax assets which are available to offset future tax obligations, of which approximately $440.0 million were acquired in the Merger and other acquisitions, 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 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.

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 where the ultimate tax determination is uncertain and 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.

Quarterly Results of Operations

The following table presents our operating results for each of the eight fiscal quarters in the period ended September 30, 2005. The information for each of these quarters is derived from our unaudited interim financial statements which have been prepared on the same basis as the audited consolidated financial statements included in this report. In our opinion, all necessary adjustments, which consist only of normal and recurring accruals as well as the special charges, in-process research and development, debt conversion costs, the gain on extinguishment of debt, and the deferred tax asset valuation allowance have been included to fairly present our unaudited quarterly results. In February 2004, Conexant completed the merger with GlobespanVirata, Inc. The results of GlobespanVirata, Inc. have been included in the consolidated results since February 28, 2004. This data should be read together with our consolidated financial statements and the notes thereto included in this report.

	Three Months Ended							
	Sept. 30, 2005	June 30, 2005	Mar. 31, 2005	Dec. 31, 2004	Sept. 30, 2004	June 30, 2004	Mar. 31, 2004	Dec. 31, 2003
	(In thousands, except per share amounts)							
Statement of Operations Data								
Net revenues	$ 214,916	$ 197,464	$ 169,738	$ 140,621	$ 213,123	$ 267,617	$ 243,781	$ 177,333
Cost of goods sold	128,312	122,430	109,766	133,465	127,681	155,136	142,116	98,196
Gross margin	86,604	75,034	59,972	7,156	85,442	112,481	101,665	79,137
Research and development	58,634	66,282	70,539	72,541	72,766	74,317	53,734	39,154
Selling, general and administrative	28,412	31,081	28,362	30,006	35,692	36,371	30,602	22,809
Amortization of intangible assets	7,920	7,969	8,140	8,293	8,205	7,956	3,653	955
In-process research and development							160,818	

Special charges	4,715	8,409	13,596	19,257	18,388	8,294	5,514	605
Total operating expenses	99,681	113,741	120,637	130,097	135,051	126,938	254,321	63,523
Operating income (loss)	(13,077)	(38,707)	(60,665)	(122,941)	(49,609)	(14,457)	(152,656)	15,614
Interest expense	8,401	8,396	8,463	8,431	8,386	8,373	7,260	6,689
Other (income) expense, net	(72,046)	(15,610)	3,429	(11,186)	70,131	47,935	(16,996)	(31,970)

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	Three Months Ended							
	Sept. 30, 2005	June 30, 2005	Mar. 31, 2005	Dec. 31, 2004	Sept. 30, 2004	June 30, 2004	Mar. 31, 2004	Dec. 31, 2003
	(In thousands, except per share amounts)							
Income (loss) before income taxes	50,568	(31,493)	(72,557)	(120,186)	(128,126)	(70,765)	(142,920)	40,895
Provision for income taxes	487	673	630	532	242,365	661	459	248
Net income (loss)	$ 50,081	$ (32,166)	$ (73,187)	$ (120,718)	$ (370,491)	$ (71,426)	$ (143,379)	$ 40,647
Income (loss) per share, basic	$ 0.11	$ (0.07)	$ (0.16)	$ (0.26)	$ (0.79)	$ (0.15)	$ (0.41)	$ 0.15
Income (loss) per share, diluted	$ 0.10	$ (0.07)	$ (0.16)	$ (0.26)	$ (0.79)	$ (0.15)	$ (0.41)	$ 0.13
Shares used in computing loss per share-basic	472,828	471,247	470,189	468,369	467,556	463,804	349,968	277,190
Shares used in computing loss per share-diluted	484,825	471,247	470,189	468,369	467,556	463,804	349,968	307,545

Throughout fiscal 2005 and 2004 we recorded special charges primarily related to our restructuring initiatives. We also recorded special charges for asset impairments and litigation settlements. See Note 15 of Notes to Consolidated Financial Statements.

In the first quarter of fiscal 2005, in response to lower market prices and reduced end-customer demand for our products, we recorded $47.0 million of inventory charges to establish additional excess and obsolete and lower of cost or market inventory reserves. In the fourth quarter of fiscal 2005, these inventory reserves were increased by a net of $2.4 million.

In each of the quarters in fiscal 2005, we recorded $7.9 million, $9.6 million, $4.6 million and $(5.0) million, sequentially, against (to) revenue to establish or adjust revenue reserves maintained by the Company to estimate customer pricing adjustments.

In the fourth quarter of fiscal 2005, we reduced certain reserves, primarily related to compensation and benefits, by approximately $2.4 million, as it was determined that such amounts would not be paid.

In the second quarter of fiscal 2004, we recorded a $160.8 million non-cash charge related to IPR&D acquired in the Merger, and in the fourth quarter of 2004, we recorded a $255.7 million non-cash charge for the impairment of our deferred tax assets.

In the past, our quarterly operating results have fluctuated due to a number of factors, many of which are outside our control. These include changes in the overall demand for communications electronics equipment, changes in product mix, the timing of new product introductions, the timing of receipt, reduction or cancellation of significant orders by customers, and other factors that have had a significant impact on our revenues and gross margins. Significant quarterly fluctuations in results of operations have also caused significant fluctuations in our liquidity and working capital, including our cash and cash equivalents, accounts receivable and payable and inventories.

Liquidity and Capital Resources

Our cash and cash equivalents increased by $63.7 million during fiscal 2005. Cash used by operating activities was $59.8 million for fiscal 2005, compared to cash used by operating activities of $31.0 million in fiscal 2004. Cash flows used in operations for fiscal 2005 was $105.2 million, before $112.0 million of net favorable changes in accounts receivable, inventories and accounts payable (exclusive of related provisions), an $8.0 million payment to Agere for the settlement of patent litigation, and $58.6 million of payments related to special charges and other restructuring related items. The favorable working capital changes were driven by (i) improved days sales outstanding primarily the result of increased cash collections, from 79 days for the fourth quarter of fiscal 2004 to 37 days in the fourth quarter of fiscal 2005, and (ii) improved inventory turns from 2.6 turns in the fourth quarter of fiscal 2004 to 5.4 turns in the fourth quarter of fiscal 2005.

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Cash provided by investing activities of $122.2 million for fiscal 2005 includes net proceeds of $49.0 million received from the purchase and sale-leaseback of our headquarters facility and other assets, proceeds from the sale of equity securities, investments and other assets, primarily the equity securities in SiRF of $97.2 million, and net sales of other marketable securities of $19.4 million. These cash flows from investing activities of approximately $165.6 million were offset by cash used in investing activities for acquisitions of $18.8 million, capital expenditures of $21.8