CONEXANT SYSTEMS INC
Form 10-Q
February 08, 2005

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

FORM 10-Q

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

For the quarterly period ended December 31, 2004

OR

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

Commission file number: 000-24923

CONEXANT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**25-1799439**
(State of incorporation)	(I.R.S. Employer Identification No.)

4000 MacArthur Boulevard
Newport Beach, California 92660-3095
(Address of principal executive offices) (Zip code)

(949) 483-4600
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

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

Number of shares of registrant s common stock outstanding as of January 28, 2005 was 469,728,299.

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CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q contains statements relating to future results of Conexant Systems, Inc. (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. Our actual results may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: the substantial losses the company has incurred recently; the cyclical nature of the semiconductor industry and the markets addressed by the company s and its customers products; demand for and market acceptance of new and existing products; successful development of new products; the timing of new product introductions and product quality; the company s 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 to develop and implement new technologies and to obtain protection of the related intellectual property; the uncertainties of litigation and the demands it may place on the time and attention of company management; and the risk that the businesses of Conexant and GlobespanVirata have not yet been completely and may not be integrated successfully, as well as other risks and uncertainties, including those set forth herein and those detailed from time to time in our filings with the Securities and Exchange Commission. 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. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONEXANT SYSTEMS, INC.

Consolidated Condensed Balance Sheets
(unaudited, in thousands, except per share amounts)

	December 31, 2004	September 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 132,326	$ 139,031
Short-term investments	135,597	163,040
Receivables, net of allowance of $5,478 and $5,974 at December 31, 2004 and September 30, 2004, respectively	92,864	185,037
Inventories	136,438	194,754
Mindspeed warrant-current portion	5,634	3,599
Other current assets	17,521	20,768
Total current assets	520,380	706,229
Property, plant and equipment, net	53,266	55,741
Goodwill	714,852	708,544
Intangible assets, net	128,947	135,241
Mindspeed warrant	35,737	23,000
Marketable securities	123,266	137,604
Other assets	112,936	114,163
Total assets	$ 1,689,384	$ 1,880,522
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 89,171	$ 141,533
Accrued compensation and benefits	44,511	40,423
Restructuring and reorganization liabilities	28,205	22,427
Other current liabilities	51,502	67,044
Total current liabilities	213,389	271,427
Convertible subordinated notes	711,825	711,825
Other liabilities	64,741	68,883
Total liabilities	989,955	1,052,135
Commitments and contingencies		

Shareholders equity:		
Preferred and junior preferred stock		
Common stock, $0.01 par value: 1,000,000 shares authorized; 469,722 and 469,441 shares issued, and 468,538 shares and 468,257 shares outstanding at December 31, 2004 and September 30, 2004, respectively	4,697	4,694
Treasury stock: 1,184 shares at cost	(5,584)	(5,584)
Additional paid-in capital	4,651,343	4,648,325
Accumulated deficit	(3,997,894)	(3,877,176)
Accumulated other comprehensive income	68,802	82,551
Notes receivable from stock sales	(386)	(576)
Unearned compensation	(21,549)	(23,847)
Total shareholders equity	699,429	828,387
Total liabilities and shareholders equity	$ 1,689,384	$ 1,880,522

See accompanying notes to consolidated condensed financial statements.

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CONEXANT SYSTEMS, INC.

Consolidated Condensed Statements of Operations
(unaudited, in thousands, except per share amounts)

	Three months ended December 31, 2004	Three months ended December 31, 2003
Net revenues	$ 140,621	$ 177,333
Cost of goods sold	133,465	98,196
Gross margin	7,156	79,137
Operating expenses:		
Research and development (including non-cash stock compensation of $2,245 and $23 for the three months ended December 31, 2004 and 2003, respectively)	72,541	39,154
Selling, general and administrative (including non-cash stock compensation of $744 and $0 for the three months ended December 31, 2004 and 2003, respectively)	30,006	22,809
Amortization of intangible assets	8,293	955
Special charges	19,257	605
Total operating expenses	130,097	63,523
Operating income (loss)	(122,941)	15,614
Other (income) expense, net	(2,755)	(25,281)
Income (loss) before income taxes	(120,186)	40,895
Provision for income taxes	532	248
Net income (loss)	$ (120,718)	$ 40,647
Net income (loss) per share basic	$ (0.26)	$ 0.15
Net income (loss) per share diluted	$ (0.26)	$ 0.13
Number of shares used in per share computation-basic	468,369	277,190
Number of shares used in per share computation-diluted	468,369	307,545

See accompanying notes to consolidated condensed financial statements.

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CONEXANT SYSTEMS, INC.

Consolidated Condensed Statements of Cash Flows
(unaudited, in thousands)

	Three months ended December 31,	
	2004	**2003**
Cash flows from operating activities:		
Net income (loss)	$ (120,718)	$ 40,647
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of effects of acquisition:		
Depreciation	4,838	3,155
Amortization of intangible assets	8,293	955
Reduction of provision for bad debt	(500)	
Inventory provisions	45,001	1,644
Increase in fair value of Skyworks note and Mindspeed warrant	(14,773)	(19,719)
Equity in losses (earnings) of equity method investees	3,089	(10,165)
Stock compensation, option modification charges and other	2,989	
Other non-cash items, net	(95)	504
Changes in assets and liabilities:		
Receivables	92,824	(6,057)
Inventories	13,427	(1,075)
Accounts payable	(53,016)	12,074
Agere patent litigation settlement	(8,000)	
Special charges, net of $10.6 million and $2.3 million of payments, respectively	8,632	(1,672)
Accrued expenses and other current liabilities	(1,291)	5,270
Other	3,250	(2,976)
Net cash provided by (used in) operating activities	(16,050)	22,585
Cash flows from investing activities:		
Cash paid for acquisition, net of cash acquired	(14,501)	
Purchases of marketable securities	(7,080)	(12,580)
Sales of marketable securities	34,170	8,266
Capital expenditures	(2,082)	(4,857)
Deferred merger costs		(1,432)
Payment of deferred purchase consideration		(4,000)
Investments in businesses	(1,755)	(471)
Net cash provided by (used in) investing activities	8,752	(15,074)
Cash flows from financing activities:		
Proceeds from exercise of stock options	397	6,065

Repayment of notes receivable from stock sales	196	
Net cash provided by financing activities	593	6,065
Net increase (decrease) in cash and cash equivalents	(6,705)	13,576
Cash and cash equivalents at beginning of period	139,031	76,186
Cash and cash equivalents at end of period	$ 132,326	$ 89,762

See accompanying notes to consolidated condensed financial statements.

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation and Significant Accounting Policies

Conexant Systems, Inc. (Conexant or the Company) designs, develops and sells semiconductor system solutions, comprised of semiconductor devices, software and reference designs, for use in broadband communications applications that enable high-speed transmission, processing and distribution of audio, video, voice and data to and throughout homes and business enterprises worldwide. The Company s access solutions connect people through personal communications access products such as personal computers (PCs), 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 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.

On February 27, 2004, the Company completed its merger with GlobespanVirata, Inc. (GlobespanVirata) with GlobespanVirata becoming a wholly-owned subsidiary of the Company. See Note 2 for further information.

Interim Reporting In the opinion of management, the accompanying unaudited consolidated condensed financial statements contain all adjustments, consisting of adjustments of a normal recurring nature, as well as the special charges, necessary to present fairly the Company s financial position, results of operations and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2004.

Fiscal Periods For presentation purposes, references made to the periods ended December 31, 2003 and 2004, relate to the actual fiscal 2004 first quarter ended January 2, 2004 and the actual first fiscal quarter of 2005 ended December 31, 2004.

Supplemental Cash Flow Information Cash paid for interest was $4.8 million and $1.4 million for the three months ended December 31, 2004 and 2003, respectively. Cash paid for income taxes for the three months ended December 31, 2004 and 2003 was $0.3 million and $0.6 million, respectively.

Revenue Recognition The Company recognizes revenues from product sales upon shipment and transfer of title, in accordance with the shipping terms specified in the arrangement with the direct customer, distributor, or other reseller. Revenue recognition is deferred in all instances where the earnings process is incomplete. The Company sells a portion of its products to electronic component distributors under agreements allowing for a right to return unsold products. The Company defers the recognition of revenue on all sales to these distributors until the products are sold by the distributors to a third party. The Company records a reserve for sales returns and allowances for direct customers and other resellers based on historical experience or specific identification of an event necessitating a reserve. Development revenue is recognized when services are performed and was not significant for any of the periods presented.

Conexant has more than 20 distributor customers for whom revenue is recognized upon its shipment of product to them, as the contractual terms provide for no rights of return. During the first fiscal quarter of 2005, the Company made a business decision to assist primarily three distribution customers to more rapidly sell their inventory by accepting net product returns of $13.3 million and making price adjustments of $7.9 million on certain of their products in inventory. As a result of implementing these returns and adjustments, which are a departure from the contractual terms with these customers, the Company has decided that it is appropriate to defer the recognition of revenue on sales to these three distributors until the purchased products are sold by the distributors to a third party.

Income (Loss) Per Share Basic income (loss) per share is based on the weighted-average number of shares of common stock outstanding during the period. Diluted loss per share also includes the effect of stock options and other common stock equivalents outstanding during the period, and assumes the conversion of the Company s convertible subordinated notes for the period of time such notes were outstanding, if such stock options and

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(unaudited)

convertible notes are dilutive. In periods of a net loss position, basic and diluted weighted average shares are the same.

The following table sets forth the computation of the numerator and denominator of basic and diluted earnings per share:

	Three months ended December 31,	
	2004	**2003**
Numerator (dollars in thousands):		
Net income (loss)- basic	$ (120,718)	$ 40,647
Effect of assumed conversion of 4.25% Convertible Subordinated Notes due 2006		439
Net income (loss)- diluted	$ (120,718)	$ 41,086
Denominator (weighted-average number of shares in thousands):		
Weighted average shares outstanding- basic	468,369	277,190
Stock options and warrants (under the treasury stock method)		22,973
Restricted stock		18
Assumed conversion of 4.25% Convertible Subordinated Notes due 2006		7,364
Weighted average shares outstanding - diluted	468,369	307,545

The potential dilutive effect of the common stock equivalents shown below was not included in the denominator for the computation of diluted earnings per share for the respective periods, as the effect of these securities was antidilutive:

	Three months ended December 31,	
(weighted-average number of shares, in thousands)	**2004**	**2003**
Stock options and warrants (under the treasury stock method)	1,921	
4.25% Convertible Subordinated Notes due 2006	7,364	
5.25% Convertible Subordinated Notes due 2006	5,840	
4.00% Convertible Subordinated Notes due 2007	12,137	12,137
Restricted stock	6	

Stock-Based Compensation The Company accounts for employee stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and therefore no compensation expense has been recognized for fixed stock option plans as options are granted at fair market value on the date of grant. The Company also has an employee stock purchase plan for all eligible employees. The Company has adopted the pro forma disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for

Stock-Based Compensation Transition and Disclosure.

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Had stock-based compensation been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company s pro forma net income (loss) and pro forma net income (loss) per share would have been the amounts indicated below (in thousands, except per share amounts):

	Three months ended December 31,	
	2004	**2003**
Net income (loss), as reported	$ (120,718)	$ 40,647
Add: expense determined under fair value accounting included in net income (loss), as reported	2,989	23
Deduct: total expense determined under fair value accounting for all awards	(18,566)	(13,130)
Pro forma net income (loss)	$ (136,295)	$ 27,540
Net income (loss) per share basic, as reported	$ (0.26)	$ 0.15
Pro forma net income (loss) per share basic	$ (0.29)	$ 0.10
Net income (loss) per share diluted, as reported	$ (0.26)	$ 0.13
Pro forma net income (loss) per share diluted	$ (0.29)	$ 0.10

For purposes of pro forma disclosures under SFAS No. 123, the estimated fair value of the stock-based awards is assumed to be amortized to expense over the instruments vesting period. The fair value has been estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

	Three months ended December 31,	
	2004	**2003**
Risk-free interest rate	3.6%	3.3%
Expected volatility	97%	97%
Dividend yield		
Expected life (years)	4.5	4.5
Weighted-average fair value of options granted	$ 1.58	$ 4.23

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because awards held by employees and directors have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of these options.

The Company accounts for non-employee stock-based compensation in accordance with the terms of SFAS No. 123 (See Note 7 - Other).

Recent Accounting Pronouncements In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (R), Share-Based Payment . This pronouncement amends SFAS No. 123, and supersedes APB Opinion No. 25. SFAS No. 123 (R) requires that public companies account for awards of equity instruments issued to employees under the fair value method of accounting and recognize such amounts in the statement of operations. This statement is effective beginning with the Company s fiscal 2005 fourth quarter beginning July 2, 2005. The Company expects the impact of this new pronouncement to be significant to its results of operations.

Cash, Cash Equivalents and Investments marketable securities The Company considers all highly liquid investments with insignificant interest rate risk and original maturities of three months or less from the date of purchase to be cash equivalents. The carrying amounts of cash and cash equivalents approximate their fair values. Short-term marketable securities consist of mutual funds, debt securities with original maturity dates between ninety days and one year, and equity securities. Long-term marketable securities consist of debt securities with original

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maturity dates greater than one year. The Company s investments are classified as available-for-sale, and are reported at fair value at the balance sheet date. The unrealized gains and losses are reported as a component of accumulated other comprehensive income (loss). Management determines the appropriate classification of debt securities at the time of purchase and reassesses the classification at each reporting date. Gains and losses on the sale of available-for-sale investments are determined using the specific-identification method.

Equity securities included in short-term marketable securities represent the Company s common stock holdings in publicly traded companies and are classified as short-term based on the Company s ability and intent to liquidate the securities as necessary to meet liquidity requirements. The reported fair value of these equity securities is based on the quoted market prices of the securities at each reporting date. Based on the overall state of the stock market, the availability of buyers for the shares when the Company wants to sell, and other restrictions, at any point in time the amounts ultimately realized upon liquidation of these securities may be significantly different than the carrying value.

Total cash, cash equivalents and marketable securities at December 31, 2004 and at September 30, 2004 are as follows (in thousands):

	December 31, 2004	September 30, 2004
Cash and cash equivalents	$ 132,326	$ 139,031
Equity securities- Skyworks Solutions, Inc. (6.2 million shares at December 31, 2004 and September 30, 2004)	58,305	61,767
Equity securities- SiRF Technologies, Inc. (5.9 million shares at December 31, 2004 and September 30, 2004)	74,705	87,509
Other short-term marketable securities (primarily mutual funds, domestic government agency securities and corporate debt securities)	2,587	13,764
Subtotal- short-term investments	135,597	163,040
Long-term marketable securities (primarily domestic government agency securities and corporate debt securities)	123,266	137,604
Total cash, cash equivalents and marketable securities	$ 391,189	$ 439,675

For all investment securities, unrealized losses that are other than temporary are recognized in net income (loss). The Company does not hold these securities for speculative or trading purposes.

2. Acquisitions

Acquisition of Paxonet Communications, Inc.

On December 3, 2004, the Company acquired all of the outstanding capital stock of Paxonet Communications, Inc. (Paxonet), a privately held company headquartered in Fremont, California, with an engineering workforce primarily based in India.

The consideration for this purchase was $14.8 million in cash. Net tangible assets acquired were $0.4 million. Approximately $0.7 million of the purchase price was allocated to unearned compensation representing the intrinsic value of unvested stock options exchanged in the transaction and the remainder to identifiable intangible assets and goodwill. The unearned compensation will be amortized to expense over the four year remaining vesting period of the stock options. The identifiable intangible assets of $2.0 million are being amortized on a straight-line basis over five years. The amount recorded as goodwill of $11.7 million is not deductible for tax purposes. The purchase price allocation is preliminary and is subject to change pending finalization of a third party valuation report of acquired identifiable intangible assets.

The pro forma effect of this acquisition was not material to the Company s results of operations for fiscal 2005 or 2004.

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Merger with GlobespanVirata, Inc.

On February 27, 2004, the Company completed its merger with 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), the Company 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 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.

The purchase consideration is summarized as follows (in thousands):

Fair market value of Conexant common stock issued	$ 1,027,342
Fair value of Conexant common stock options issued	81,011
Transaction costs	12,900
Total purchase consideration	$ 1,121,253

The fair value of Conexant common stock and stock options issued of $1.1 billion has been allocated to common stock and additional paid in capital. The fair market value of the 180.6 million shares of common stock issued was determined using a per share price of $5.69 (the average of the closing market prices of Conexant common stock on the day of the announcement of the Merger, November 3, 2003, and on the three business days before and after the announcement date). In accordance with FASB Interpretation No. 44 Accounting for Certain Transactions Involving Stock Compensation , the $111.9 million fair value of the 43.6 million Conexant common stock options granted to replace the acquired common stock options was determined using a Black-Scholes option pricing model with the following assumptions: market price of $5.69 per share, volatility of 97%, risk-free rate of return of 3.2%, expected lives of 4.5 years and no dividend yield. Approximately $30.9 million in intrinsic value associated with the unvested stock options has been allocated to unearned compensation and will be amortized to expense over the average remaining vesting period of approximately 2.6 years. A total of $3.0 million of this unearned compensation was recognized as an expense in the three months ended December 31, 2004.

In connection with the Merger, the Company began to formulate a reorganization and restructuring plan (the Reorganization Plan). As a result of the Reorganization Plan, through September 30, 2004, the Company recognized an aggregate of $11.5 million as liabilities assumed in the purchase business combination related to restructuring liabilities for estimated costs related to Conexant, Inc. facilities consolidation and the related impact on Conexant, Inc. outstanding real estate leases and Conexant, Inc. involuntary employee terminations and relocations. These liabilities were included in the allocation of the purchase price in accordance with SFAS No. 141 entitled Business Combinations and EITF 95-3 entitled Recognition of Liabilities in Connection with a Purchase Business Combination . The Reorganization Plan was complete as of December 31, 2004 and no adjustments were made to goodwill for these actions during the first fiscal quarter of 2005.

In the Merger, the Company acquired a reserve for income tax contingencies for foreign income tax matters which arose due to items recorded in the income tax returns of the former GlobespanVirata subsidiaries. As of September 30, 2004, this reserve balance was $8.2 million. In the quarter ended December 31, 2004, a portion of this income tax contingency was settled with the taxing authorities, and as a result, the amount of the liability in excess of the settlement amount of $5.4 million was reduced with a corresponding reduction to goodwill. As the remaining pre-acquisition contingencies continue to evolve and settle with the taxing authorities, the Company will record such changes, favorable or unfavorable, against the purchase price allocation (goodwill) through the expiration of the allocation period (the end of the fiscal 2005 second quarter) as defined by SFAS No. 141. If the contingencies are not settled by the end of the fiscal 2005 second quarter, any changes after that date, whether favorable or unfavorable, will be recorded to operations.

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The following sets forth the Company s estimates of the fair values of the assets acquired and liabilities assumed in the Merger (in thousands). The amounts below may change further through the end of the allocation period.

Cash and cash equivalents	$ 42,515
Short-term and long-term investments	153,099
Accounts receivable	91,259
Inventories	73,281
Prepaids and other current assets	4,236
Property and equipment	46,883
Other long-term assets	20,600
Identifiable intangible assets	137,931
In-process research and development	160,818
Goodwill	626,981
Accounts payable	(41,580)
Accrued expenses	(72,626)
Accrued restructuring and reorganization liabilities	(11,465)
Long-term debt	(130,000)
Other long-term liabilities	(23,284)
Treasury stock	9,188
Notes receivable from stock sales	2,469
Unearned compensation	30,948
Net assets acquired	$ 1,121,253

The excess of the purchase price over the fair value of the net tangible assets acquired has been reflected as identifiable intangible assets and goodwill. The identifiable intangible assets and respective useful lives are as follows (in thousands):

Product licenses (7 years)	$ 10,964
Trademark (7 years)	2,006
Developed technologies (2 5 years)	124,961
Total identifiable intangible assets	$ 137,931

The identifiable intangible assets were valued using the income approach and a discount rate of 18%. The developed technologies consist of eight products in the digital subscriber line (DSL) and wireless local area network (LAN) categories. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated by the products incorporating the current technology. The type of income approach utilized for the trademark was the relief from royalty methodology, under which an estimate is made as to the appropriate royalty income that would be negotiated in an arm s length transaction if the subject intangible asset were licensed from an independent third party owner. These assets are being amortized on a straight-line basis over their estimated useful lives ranging from 2 to 7 years, with a weighted-average life of approximately 5 years. Amortization expense for these intangible assets was $6.9 million for the three months ended December 31, 2004. The Company does not believe that any indicator of permanent impairment exists with respect to the identifiable intangible assets. The Company continues to evaluate the indicators of impairment and if such indicators are determined to exist, the Company will formally evaluate the recoverability of these assets. The amount recorded as goodwill of $627.0 million is not deductible for tax purposes.

The amount allocated to in process research and development (IPR&D) of $160.8 million was expensed upon completion of the Merger (as a charge not deductible for tax purposes) as it was determined that the underlying products had not reached technological feasibility, had no alternative uses and successful development was uncertain. The Company identified and valued two IPR&D projects relating to the development of DSL and wireless networking products. The DSL project represented 70% of the total IPR&D acquired. Both projects were approximately 87% complete at the date of the merger. The estimated costs to complete for the DSL and wireless networking projects were approximately $14.1 million and $6.2 million, respectively. These projects are planned to be completed in fiscal 2005. The fair values assigned to these projects were based on the income approach and used projected cash flows which were discounted at a rate of 19%. The discount rate was derived from a weighted-

CONEXANT SYSTEMS, INC.
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average cost of capital analysis, adjusted upwards to reflect additional risks inherent in the development process, including the probability of achieving technological success and market acceptance. Each of the IPR&D projects was analyzed considering technological innovations, the existence and utilization of core technology, the complexity, costs and time to complete the remaining development efforts, and stage of completion. The discount rate reflects the stage of completion and other risks inherent in the projects. The material risks associated with the incomplete projects are the ability to complete the items within the outlined timeframes and within the allocated cost guidelines, and ultimately to sell the products to end-users.

Management is responsible for the amounts determined for IPR&D as well as developed technologies and believes that these amounts are representative of fair values. Actual results do not differ materially from the estimates used in the valuation of IPR&D.

The treasury stock of $9.2 million represents the value of the 1.25 million shares of Conexant common stock held by iCompression, a subsidiary of the former GlobespanVirata, which were effectively repurchased at the Merger closing date of February 27, 2004.

The Merger was accounted for as a purchase and the operating results of the former GlobespanVirata have been included in the Company s operations from the closing date. The following unaudited pro forma information represents a summary of the results of operations as if the Merger occurred at the beginning of the period presented and includes amortization of identifiable intangibles and unearned compensation from that date.

		Three months ended Dec. 31, 2003
Net revenues	$	314,581
Net income	$	38,633
Net income per common share basic	$	0.08
Net income per common share diluted	$	0.08

The pro forma results are based on various assumptions and are not necessarily indicative of what would have occurred had the Merger closed on October 1, 2003.

Acquisition of Amphion Semiconductor

On June 29, 2004, the Company purchased all the outstanding capital stock of Amphion Semiconductor Limited (Amphion), a company located in Belfast, Northern Ireland specializing in developing video compression technology. The Company completed this strategic acquisition as a complement to existing products. The consideration for this purchase was $20.0 million in cash, 600,000 shares of common stock (valued at $6.0 million) and $0.4 million in transaction costs. Net tangible assets acquired were $2.4 million. The excess of the purchase price over the net tangible assets was assigned to developed technology of $4.2 million and $19.4 million to goodwill. The developed technology will be amortized on a straight-line basis over five years. The amount recorded as goodwill of $19.4 million is not deductible for tax purposes.

Under the stock purchase agreement, the Company guaranteed the value of the shares issued to the former Amphion shareholders for a defined period through June 29, 2006 (subject to certain conditions and elections). The guaranty is subject to adjustment for any stock split, stock dividend, recapitalization, merger or similar transaction. In the event that the market price of the Conexant common stock does not equal or exceed $10.00 for at least five consecutive trading days during this period, Conexant would be required to make an additional payment (in cash or additional shares of common stock at Conexant s option) to former Amphion shareholders for the difference between the $10.00 and the market price per share of such shares as of specified dates. Consequently, the Company has valued the shares delivered to the former Amphion shareholders at the guaranteed value of $10.00 per share, or a total of $6.0 million. To the extent the Company is required to make an additional payment under the guaranty, the payment will not increase the total purchase price.

The terms of this acquisition include provisions under which the former shareholders of Amphion could receive additional consideration of up to $4.0 million during the twelve to eighteen months following the acquisition if

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certain technology milestones are achieved. This contingent consideration has not been included in the purchase price allocation and if earned, such amounts will be capitalized as an addition to goodwill.

The pro forma effect of this acquisition was not material to the Company s results of operations for fiscal 2004.

3. Supplemental Financial Statement Data

Marketable Securities

Marketable securities consist of short-term investments and long-term investments, all of which are classified as available-for-sale securities as follows:

Short-term investments (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
December 31, 2004:				
Corporate debt securities	$ 1,405	$	$ (2)	$ 1,403
Equity securities	56,524	77,670		134,194
	$ 57,929	$ 77,670	$ (2)	$ 135,597
September 30, 2004:				
Mutual funds	$ 10,837	$	$ (125)	$ 10,712
Corporate debt securities	2,274		(3)	2,271
Equity securities	56,524	93,533		150,057
	$ 69,635	$ 93,533	$ (128)	$ 163,040

The mutual fund holdings at September 30, 2004 were invested in adjustable rate mortgages and government agency securities.

Long-term investments (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
December 31, 2004:				
Domestic government agency securities	$ 88,738	$	$ (434)	$ 88,304

Corporate debt securities		35,202		3		(243)	34,962
	$	123,940	$	3	$	(677)	$ 123,266
September 30, 2004:							
Domestic government agency securities	$	105,956	$		$	(800)	$ 105,156
Corporate debt securities		32,595				(147)	32,448
	$	138,551	$		$	(947)	$ 137,604

The Company s long-term marketable securities principally have original contractual maturities from one to three years.

Inventories

Inventories consist of the following (in thousands):

		December 31, 2004		September 30, 2004
Work-in-process	$	70,785	$	99,226
Finished goods		65,653		95,528
	$	136,438	$	194,754

At December 31, 2004 and September 30, 2004, inventories are net of $49.5 million and $23.3 million, respectively, of allowances for excess and obsolete inventories. In addition, at December 31, 2004, inventories are net of $18.8 million in lower of cost or market reserves.

In the quarter ended December 31, 2004, in response to lower market prices and reduced end-customer demand for Broadband Access and Wireless Networking products, the Company recorded $26.2 million in excess and obsolete charges and $18.8 million of charges to reduce certain Wireless Networking inventory to its estimated lower of cost or market value.

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Goodwill

During the first quarter of fiscal 2005, goodwill was adjusted as follows (in thousands):

Goodwill, September 30, 2004	$ 708,544
Acquisition of Paxonet	11,731
Adjustments to prior purchase price allocation (1)	(5,423)
Goodwill, December 31, 2004	$ 714,852

(1) In the Merger, the Company acquired a reserve for income tax contingencies for foreign income tax matters which arose due to items recorded in the income tax returns of the former GlobespanVirata subsidiaries. In the quarter ended December 31, 2004, a portion of this income tax contingency was settled with the taxing authorities, and as a result, the amount of the liability in excess of the settlement amount of $5.4 million was reduced with a corresponding reduction to goodwill.

Intangible Assets

Intangible assets consist of the following (in thousands):

	December 31, 2004			September 30, 2004		
	Gross Asset	Accumulated Amortization	Net	Gross Asset	Accumulated Amortization	Net
Developed technology	$ 145,946	$ (32,659)	$ 113,287	$ 145,946	$ (25,359)	$ 120,587
Customer base	4,050	(1,052)	2,998	2,050	(847)	1,203
Other intangible assets	20,908	(8,246)	12,662	20,908	(7,457)	13,451
	$ 170,904	$ (41,957)	$ 128,947	$ 168,904	$ (33,663)	$ 135,241

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

	Remainder of 2005	2006	2007	2008	2009	Thereafter
Amortization expense	$ 23,651	$ 30,301	$ 29,569	$ 29,114	$ 13,611	$ 2,701

Mindspeed Warrant

The Company accounts for the Mindspeed warrant as a derivative instrument, and changes in the fair value of the warrant are included in other (income) expense, net each period. At December 31, 2004, the aggregate fair value of the Mindspeed warrant included on the accompanying consolidated condensed balance sheet was $41.4 million. The current portion of $5.6 million was determined using current pricing data, and the remaining portion was valued using a Black-Scholes model with terms for portions of the warrant varying from 1 to 5 years, volatility of 90%, a risk-free interest rate of 3.2% and no dividend yield. It is the Company s intent to liquidate the portion of this warrant classified as current in the next twelve months.

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

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Convertible Subordinated Notes

At December 31, 2004, the components of convertible subordinated notes are as follows (in thousands):

4.00% Convertible Subordinated Notes due February 2007 with a conversion price of $42.43	$ 515,000
4.25% Convertible Subordinated Notes due May 2006 with a conversion price of $9.08	66,825
5.25% Convertible Subordinated Notes due May 2006 with a conversion price of $22.26	130,000
Total convertible subordinated notes	$ 711,825

Other (Income) Expense, Net

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

	Three months ended December 31,	
	2004	**2003**
Investment and interest income	$ (551)	$ (2,497)
Decrease in fair value of the conversion right under the Skyworks 15% convertible senior subordinated notes		4,911
Increase in fair value of the Mindspeed warrant	(14,773)	(24,630)
Interest expense	8,431	6,689
Equity in (earnings) losses of equity method investees	3,089	(10,165)
Other	1,049	411
Other (income) expense, net	$ (2,755)	$ (25,281)

During the three months ended December 31, 2003, an unrelated party repaid a $30.0 million note issued in connection with a previous equity investment in Jazz Semiconductor, Inc., in which the Company owns a 38% interest. In accordance with Staff Accounting Bulletin No. 51, the Company recognized an $11.4 million gain upon the payment of this note, which is included in equity in earnings of equity method investees.

4. Skyworks Notes

In November 2002, the Company restructured its previous financing agreements with Skyworks whereby Skyworks repaid $105.0 million of the principal amount and all accrued interest owed to the Company under the $150.0 million promissory notes issued by Skyworks and certain Skyworks subsidiaries and collateralized by substantially all of the assets of Skyworks (the Term Notes), and the remaining principal amount of the Term Notes was exchanged for $45.0 million principal amount of the Skyworks 15% convertible senior subordinated notes with a maturity date of June 30, 2005. At the same time, Skyworks also repaid all amounts outstanding under the previous credit facility, the credit facility was cancelled and the Company released all security interests in Skyworks assets and properties.

The Company received a notice dated April 22, 2004 from Skyworks advising that on May 12, 2004, Skyworks would redeem in full the 15% convertible senior subordinated notes held by the Company. The Company exercised its right to convert all of the notes into shares of Skyworks common stock prior to the scheduled redemption date at the conversion price of $7.87 per share. On May 10, 2004, the Company received 5.7 million shares of Skyworks common stock in full satisfaction of the notes.

5. Commitments and Contingencies

Legal Matters

Certain claims have been asserted against the Company, including claims alleging the use of the intellectual property rights of others in certain of the Company s products. The resolution of these matters may entail the negotiation of a

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license agreement, a settlement, or the adjudication of such claims through arbitration or litigation. The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably 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, results of operations, or cash flows of the Company.

IPO Litigation. In November 2001, Collegeware Asset Management, LP, on behalf of itself and a putative class of persons who purchased Conexant, Inc. common stock 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 Conexant, Inc. s initial and secondary public offerings as well as certain Conexant, Inc. officers and directors. The complaint alleges that the defendants violated federal securities laws by issuing and selling Conexant, 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 approximately 300 other actions making similar allegations regarding the public offerings of hundreds of other companies during 1998 through 2000. In June 2003, the issuers, the individual defendants and plaintiffs reached a tentative settlement agreement that would, among other things, result in the dismissal with prejudice of all claims against Conexant, Inc. s officers and directors. The settlement remains subject to a number of conditions, including class certification and approval of the settlement by the court. It is possible that the parties will not reach agreement on the final settlement or 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, the Company believes that the Conexant, Inc. officers and directors have meritorious defenses to the plaintiffs claims and expects that those defendants will defend themselves vigorously. The Company also believes that it has sufficient insurance coverage to cover any indemnification obligations to the directors and officers related to this litigation.

Texas Instruments, Inc. The Company s Conexant, Inc. subsidiary has been involved in a dispute with Texas Instruments, Inc. (Texas Instruments) 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. Although the Company believes that Conexant, Inc. has strong arguments in favor of its position in this dispute, it 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 the Company s business, financial condition and results of operations.

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Class Action Suits. In December 2004 and January 2005, the Company and certain current and former officers were named as defendants in several complaints filed on behalf of all persons who purchased Company common stock during a specified class period in the U.S. District Court of New Jersey and the U.S. District Court for the Central District of California, 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 defendants believe these charges are without merit and intend to vigorously defend the litigation.

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 in California State 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. The defendants believe these charges are without merit and intend to vigorously defend the litigation.

Agere Systems, Inc. On November 4, 2004, the Company reached a settlement with Agere Systems Inc. (Agere), which among other things, dismissed with prejudice all litigation matters between the two companies. The settlement agreement also provided for the dismissal with prejudice of all claims brought by and against Intersil. Conexant, Inc. (formerly GlobespanVirata, Inc.) acquired the WLAN Group of Intersil in August 2003. As part of this overall litigation settlement, the Company made a cash payment, which was accrued in fiscal 2004, to Agere in the amount of $8.0 million in November 2004 and the two companies entered into various license agreements covering the patents involved in the suits and other semiconductor devices.

Other

The Company has been designated as a potentially responsible party and is 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 occupied by the Company. In addition, the Company is engaged in remediation of groundwater contamination at its former Newport Beach, California wafer fabrication facility. Management currently estimates the aggregate remaining costs for these remediations to be approximately $3.0 million and has accrued for these costs as of December 31, 2004.

The Company leases certain facilities and equipment under non-cancelable operating leases which expire at various dates through 2021 and contain various provisions for rental adjustments including, in certain cases, adjustments based on increases in the Consumer Price Index. The leases generally contain renewal provisions for varying periods of time. Rental expense under operating leases was approximately $5.7 million and $4.4 million for the three months ended December 31, 2004 and 2003, respectively.

At December 31, 2004, future minimum lease payments under operating leases, excluding any sublease income, were as follows (in thousands):

Fiscal Year	
2005 remaining 9 months	$ 21,620
2006	21,445
2007	16,795
2008	12,114

2009	9,172
Thereafter	62,097
Total future minimum lease payments	$ 143,243

At December 31, 2004, the Company has many sublease arrangements on operating leases for terms ranging from near term to approximately 6 years. Aggregate scheduled sublease income based on current terms is approximately $7.5 million.

The summary of future minimum lease payments includes an aggregate gross amount of $44.7 million of lease obligations that principally expire through fiscal 2021, which have been accrued for in connection with the

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Company s reorganization and restructuring actions (see Note 7) and previous actions taken by GlobespanVirata prior to the Merger.

The Company purchases a portion of its requirements for silicon-based semiconductor products from Jazz Semiconductor, Inc. (Jazz). In the event the Company s actual wafer purchases are less than the required minimum volumes, it will be required to make additional payments to Jazz. The Company s expected minimum purchase obligations under the supply agreement with Jazz, net of a portion of the wafer purchase obligations assumed by a third party, will be approximately $7.0 million for the remainder of fiscal year 2005. The Company is contingently liable for the approximate $6.0 million in the minimum purchase obligations assumed by that third party.

Additionally, the Company entered into a supply agreement with Skyworks in June 2002, under which Skyworks provides semiconductor assembly and test services at the Company s former Mexicali, Mexico facility. Under this supply agreement, the Company is obligated to purchase certain minimum amounts of assembly and test services for the remainder of fiscal 2005 in the amount of $7.2 million. In the event the Company s purchases of assembly and test services are less than the required minimum amounts, it will be required to make additional payments to Skyworks.

The Company currently anticipates meeting each of the minimum purchase obligations under the supply agreements with Jazz and Skyworks.

At December 31, 2004, the Company is contingently liable for approximately $14.6 million in operating lease commitments on facility leases that were assigned to Mindspeed and Skyworks at the time of their separation from the Company.

In connection with certain non-marketable equity investments, the Company may be required to invest up to an additional $4.4 million as of December 31, 2004.

The Company has exercised its purchase option for approximately $60.0 million to purchase two buildings in Newport Beach, California which are currently occupied under a lease agreement. The Company s plan is to complete a sale-leaseback transaction with respect to these facilities in the quarter ending March 31, 2005.

The Company has made commitments to certain employees in the amount of $4.6 million as of December 31, 2004. Such amounts will be earned and paid over the next twelve months.

6. Comprehensive Income (Loss)

Comprehensive income (loss) is as follows (in thousands):

	Three months ended December 31,	
	2004	**2003**
Net income (loss)	$ (120,718)	$ 40,647
Other comprehensive income (loss):		
Foreign currency translation adjustments	1,628	458

Change in unrealized gains on available-for-sale securities	(15,464)	(451)
Minimum pension liability adjustments	87	86
Effect of income taxes		172
Other comprehensive income (loss)	(13,749)	265
Comprehensive income (loss)	$ (134,467)	$ 40,912

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The components of accumulated other comprehensive income are as follows (in thousands):

	December 31, 2004	September 30, 2004
Foreign currency translation adjustments	$ (1,578)	$ (3,206)
Unrealized gains on available-for-sale securities	76,994	92,458
Minimum pension liability adjustments	(6,614)	(6,701)
Accumulated other comprehensive income	$ 68,802	$ 82,551

7. Special Charges

Special charges consist of the following (in thousands):

	Three months ended December 31, 2004	Three months ended December 31, 2003
Asset impairments	$ 455	$ 153
Restructuring charges	11,971	448
Integration charges	3,525	
Other	3,306	4
	$ 19,257	$ 605

Asset Impairments

During the first fiscal quarter of 2005, the Company recorded asset impairment charges of $0.5 million related to various operating assets which were determined to be redundant and no longer required as a result of restructuring activities. These assets have been abandoned.

Restructuring Charges

The Company has implemented a number of cost reduction initiatives since late fiscal 2001 to improve its operating cost structure. The cost reduction initiatives included workforce reductions, and the closure or consolidation of certain facilities, among other actions. The costs and expenses associated with the restructuring activities, except for the liabilities associated with the 2004 Reorganization Plan that related to the employees and facilities of Conexant, Inc., are included in special charges in the accompanying consolidated condensed statements of operations. The costs and expenses resulting from the 2004 Reorganization Plan which related to the employees and facilities of Conexant, Inc.

have been recorded as acquired liabilities in the Merger and included as part of the purchase price allocation in accordance with EITF 95-3 and SFAS No. 141 (see Note 2). Subsequent actions that impacted the employees and facilities of Conexant, Inc. have been included in special charges on the Company s statements of operations.

2005 Restructuring Action In November 2004, the Company announced additional plans to reduce its operating expense level by the end of the fourth fiscal quarter of 2005. The components of this plan are a shift of product development resources to lower-cost regions and cost savings from continued Merger-related sales, general and administrative consolidation. During the first fiscal quarter of 2005, the Company completed numerous senior management changes and notified an additional 13 employees in selling, general and administrative areas of their involuntary termination. The Company recorded total charges of $6.1 million based on the estimates of the cost of severance benefits for the affected employees and will charge an additional $0.5 million to restructuring expense in the next two fiscal quarters as certain severance benefits are earned. Additionally, the Company recorded restructuring charges of $4.0 million relating to the consolidation of certain facilities under non-cancelable leases which were vacated. The facility charges were determined in accordance with the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities . As a result, the Company recorded the present value of the future lease obligations, in excess of the expected future sublease income, using a discount rate of approximately 8.0%, and will accrete the approximate $2.2 million into expense over the remaining life of the leases. The accrual for facility charges includes a $1.0 million non-cash reclassification of a portion of the deferred

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gain on the previous sale of the facility, which has now been partially vacated. Subsequent to December 31, 2004, the Company launched an additional set of headcount reduction actions.

Activity and liability balances recorded as part of the 2005 Restructuring Action through December 31, 2004 were as follows (in thousands):

	Workforce reductions	Facility and other	Total
Charged to costs and expenses	$ 6,073	$ 4,006	$ 10,079
Non-cash items	(22)	979	957
Cash payments	(3,333)		(3,333)
Restructuring balance, December 31, 2004	$ 2,718	$ 4,985	$ 7,703

2004 Restructuring Actions The Company approved several restructuring plans during fiscal 2004. In connection with the Merger, the Company began to formulate a plan which included workforce reductions and facility consolidation actions. This plan was communicated at the time of the Merger and has been completed (the 2004 Merger Related Restructuring and Reorganization Plans). During the fourth fiscal quarter of 2004, the Company announced additional workforce reduction and facility consolidation actions in response to lower than anticipated revenue levels.

In connection with the Merger, the Company began to formulate the 2004 Merger Related Reorganization Plan which consisted primarily of workforce reductions to eliminate redundant positions and consolidation of worldwide facilities. The portions of the plan that pertained to Conexant, Inc. employees and facilities were recorded as acquired liabilities in the Merger and included as part of the purchase price allocation, in accordance with EITF No. 95-3 and SFAS No. 141. This plan consisted of an involuntary workforce reduction which affected approximately 35 employees of Conexant, Inc. These employees were located in the United States in sales and administrative functions. The charge associated with these workforce reductions of approximately $1.3 million was based upon estimates of the severance and fringe benefits for the affected employees, in addition to relocation benefits for others. The facility consolidation plan resulted in an initial charge of $13.5 million and included assumptions regarding sublease rates and time periods and other costs to prepare and sublease the applicable spaces. Additionally, at the date of the Merger, there had been a decline in the real estate market in certain geographic regions in which Conexant, Inc. had leased facilities. A portion of the facilities related charges represent adjustments to the fair market value rates of those leases. These non-cancelable lease commitments range from near term to 17 years in length. The Company reduced the original facility consolidation charge by approximately $3.6 million and increased the workforce related charge by approximately $0.2 million as a result of finalizing the 2004 Merger Related Reorganization Plan and recorded these changes as adjustments to the purchase price allocation (goodwill).

Activity and liability balances recorded as part of the 2004 Merger Related Reorganization Plan pertaining to Conexant, Inc. employees and facilities through December 31, 2004 were as follows (in thousands):

	Workforce reductions	Facility and other	Total

Recorded in purchase price allocation	$ 1,300	$ 13,509	$ 14,809
Adjusted to purchase price allocation	210	(3,554)	(3,344)
Cash payments	(536)	(788)	(1,324)
Restructuring balance, September 30, 2004	974	9,167	10,141
Cash payments	(277)	(273)	(550)
Restructuring balance, December 31, 2004	$ 697	$ 8,894	$ 9,591

The portion of the 2004 restructuring actions pertaining to Conexant Systems, Inc. employees and facilities was recorded to special charges during fiscal 2004 (the 2004 Merger Related Restructuring Plan). Approximately 90 employees in the sales and administrative and information technology areas were involuntarily terminated, resulting in charges of $1.9 million, which was based upon estimates of severance benefits for the affected employees. These

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employees left the Company through December 2004. Additionally, the Company recorded restructuring charges of $1.9 million relating to the consolidation of certain facilities under non-cancelable leases which were vacated.

During the fourth fiscal quarter of 2004, the Company announced additional workforce reduction actions in response to lower than anticipated revenue levels. The Company has recorded a total of $9.0 million based on the estimates of the cost of severance benefits for the affected employees and will charge an additional $0.8 million to restructuring expense in the next two fiscal quarters as certain severance benefits are earned. The Company notified approximately 230 employees of their involuntary termination, including approximately 180 domestic and 50 international employees. These employees will be leaving the Company through June 2005. The workforce reductions affected employees in all areas of the business.

Activity and liability balances recorded as part of the 2004 Merger Related Restructuring Plan pertaining to Conexant Systems, Inc. employees and facilities and the additional fourth fiscal quarter of 2004 restructuring action through December 31, 2004 were as follows (in thousands):

	Workforce reductions	Facility and other	Total
Charged to costs and expenses	$ 7,066	$ 1,877	$ 8,943
Cash payments	(2,368)	(281)	(2,649)
Restructuring balance, September 30, 2004	4,698	1,596	6,294
Charged to costs and expenses	1,892		1,892
Cash payments	(2,034)	(197)	(2,231)
Restructuring balance, December 31, 2004	$ 4,556	$ 1,399	$ 5,955

2003 Corporate Restructuring Plan In the fourth quarter of fiscal 2003, the Company initiated another workforce reduction, closed a design center and consolidated some facilities. The Company involuntarily terminated employees in the sales and administration areas and recorded charges aggregating $1.2 million based upon estimates of the cost of severance benefits for the affected employees. The Company also recorded restructuring costs of $2.8 million relating to the consolidation of certain facilities under non-cancelable leases which were vacated.

Activity and liability balances related to the 2003 Corporate Restructuring Plan through December 31, 2004 were as follows (in thousands):

	Workforce reductions	Facility and other	Total
Charged to costs and expenses	$ 1,181	$ 2,830	$ 4,011
Cash payments	(364)		(364)
Restructuring balance, September 30, 2003	817	2,830	3,647
Charged to costs and expenses	350	98	448

Expense reversal	(81)		(81)
Cash payments	(1,086)	(933)	(2,019)
Restructuring balance, September 30, 2004		1,995	1,995
Cash payments		(38)	(38)
Restructuring balance, December 31, 2004	$	$ 1,957	$ 1,957

2002 Corporate and Manufacturing Restructuring Plan During fiscal 2002, the Company initiated a further reduction of its workforce throughout its operations primarily as a result of the divestiture of its Newport Beach wafer fabrication operations and the spin-off and merger of the Company s wireless communications business with Alpha Industries, Inc. to form Skyworks. In connection with the fiscal 2002 corporate and manufacturing restructuring actions, the Company terminated approximately 120 employees and recorded charges aggregating $2.4 million based upon estimates of the cost of severance benefits for the affected employees. The Company completed these actions in fiscal 2002. In addition, the Company recorded restructuring charges of $12.5 million for costs associated with the consolidation of certain facilities and commitments under license obligations that management determined would not be used in the future.

As part of the 2002 Corporate and Manufacturing Restructuring Plan, during the first quarter of fiscal 2003, the Company initiated a further workforce reduction affecting 58 employees and recorded additional charges of $1.9

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million based upon estimates of the cost of severance benefits for the affected employees. During the third quarter of fiscal 2003, the Company revised its estimate of liabilities for severance benefits and facility costs due to unfavorable sublease experience to date, and charged an additional $1.5 million to restructuring. In the fourth quarter of 2003, the Company reversed $1.1 million of the estimated cost to settle the remaining commitment under a license obligation after its favorable resolution, and increased the estimate of remaining facility costs due to unfavorable sublease experience.

Activity and liability balances related to the 2002 Corporate and Manufacturing Restructuring Plan through December 31, 2004 were as follows (in thousands):

	Workforce reductions	Facility and other	Total
Charged to costs and expenses	$ 2,437	$ 12,519	$ 14,956
Cash payments	(1,664)	(431)	(2,095)
Restructuring balance, September 30, 2002	773	12,088	12,861
Charged to costs and expenses	2,898	888	3,786
Expense reversal		(1,100)	(1,100)
Cash payments	(3,173)	(3,930)	(7,103)