CONEXANT SYSTEMS INC
Form 10-K
November 09, 2010

Table of Contents

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 October 1, 2010
	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	**92660-3095**
Newport Beach, California	*(Zip code)*
(Address of principal executive offices)	

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Common Stock, $0.01 Par Value Per Share	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities registered pursuant to Section 12(g) of the Act:
None

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

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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 Global Select Market on April 2, 2010) was approximately $287 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 5, 2010 was 82,063,068.

Documents Incorporated by Reference

Portions of the registrant s Proxy Statement for the 2011 Annual Meeting of Shareholders to be held on January 20, 2011 are incorporated by reference into Part III of the Form 10-K.

Table of Contents

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of the federal securities laws. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words, such as may, will, could, project, believe, an expect, estimate, continue, potential, plan, forecasts, and the like, the negatives of such expressions, or the us future tense. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions. Examples of forward-looking statements include, but are not limited to, statements concerning:

- our expectations regarding the market share of our products, growth in the markets we serve and our market opportunities;
- our expectations regarding price and product competition;
- our expectations regarding continued demand and future growth in demand for our products in the communications, PC and consumer markets we serve;
- our expectations regarding the declines in our legacy products;
- our plans and expectations regarding the transition of our semiconductor products to smaller line width geometries;
- our expectation that we will be able to sustain the recoverability of our goodwill, intangible and tangible long-term assets;
- our product development plans;
- our expectations regarding the sale of our real property in Newport Beach;
- our expectation that our largest customers will continue to account for a substantial portion of our revenue;
- our expectations regarding our contractual obligations and commitments;
- our expectation that we will be able to protect our products and services with proprietary technology and intellectual property protection;
- our expectation that we will be able to meet our lease obligations (and other financial commitments);
- our expectations, subject to the qualifications expressed, regarding the sufficiency of our existing sources of liquidity, together with cash expected to be generated from operations, to fund our operations, research and development, anticipated capital expenditures, and working capital for at least the next twelve months;
- our expectation that we will be able to continue to rely on third party manufacturers to manufacture, assemble and test our products to meet our customers demands; and
- our expectations that we will be able to use our net operating losses and other tax attributes to offset future taxable income.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. You are urged to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including, but not limited to, those made in Part I, Item 1A of this Annual Report on Form 10-K, and any of those made in our other reports filed with the Securities and Exchange Commission (SEC). Please consider our forward-looking statements in light of those risks as you read this Annual Report on Form 10-K. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. We do not intend, and undertake no obligation, to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

CONEXANT SYSTEMS, INC.

TABLE OF CONTENTS

PART I

Item 1. *Business*

General

We design, develop and sell semiconductor system solutions, comprised of semiconductor devices, software and reference designs, for imaging, audio, embedded-modem, and video applications. These solutions include a comprehensive portfolio of imaging solutions for multifunction printers (MFPs), fax platforms, and interactive display frame market segments. Our audio solutions include high-definition (HD) audio integrated circuits, HD audio codecs, and speakers-on-a-chip solutions for personal computers, PC peripheral sound systems, audio subsystems, speakers, notebook docking stations, voice-over-IP speakerphones, USB headsets supporting Microsoft Office Communicator and Skype, and audio-enabled surveillance applications. We also offer a full suite of embedded-modem solutions for set-top boxes, point-of-sale systems, home automation and security systems, and desktop and notebook PCs. Additional products include decoders and media bridges for video surveillance, security and monitoring applications, and system solutions for analog video-based multimedia applications.

Our principal corporate office is located at 4000 MacArthur Boulevard, Newport Beach, CA 92660, and our main telephone number at that location is 949-483-4600. Our common stock trades on the NASDAQ Global Select Market under the symbol CNXT.

We were incorporated in Delaware in September 1996 and have been operating in the communications semiconductor business, including as part of the semiconductor systems business of Rockwell International Corporation (now Rockwell Automation, Inc.) since that time. We have been an independent public company since January 1999, following our spin-off from Rockwell. Since then, we have transformed our company from a broad-based communications semiconductor supplier into a fabless communications semiconductor supplier focused on delivering the technology and products for imaging, audio, embedded-modem, and video applications.

Divestitures

In August 2009, we completed the sale of certain assets related to our Broadband Access (BBA) business to Ikanos Communications, Inc. (Ikanos) for an aggregate consideration of approximately $54 million. Assets sold pursuant to the agreement with Ikanos include specified intellectual property, inventory, contracts, and tangible assets. Ikanos assumed certain liabilities, including obligations under transferred contracts and certain employee-related liabilities. We also granted to Ikanos a license to use certain of our retained technology assets in connection with Ikanos current and future products in certain fields of use, along with a patent license covering certain of our retained patents to make, use, and sell such products (or, in some cases, components of such products).

In August 2008, we completed the sale of certain assets related to our Broadband Media Processing (BMP) business to NXP B.V. (NXP) for an aggregate consideration of approximately $110 million. Assets sold pursuant to the agreement with NXP include, among other things, specified patents, inventory, contracts and intangible assets. NXP assumed certain liabilities, including obligations under transferred contracts and certain employee-related liabilities. We also granted NXP a license to use certain of our retained technology assets in connection with NXP s current and future products in certain fields of use, along with a patent license covering certain of our retained patents to make, use and sell such products (or, in some cases, components of such products).

Strategy

Our objective is to become a leading supplier of semiconductor solutions and Application Specific Standard Products (ASSPs) to leading global original equipment manufacturer (OEM) and original design manufacturer (ODM) customers in consumer, communications, imaging, security, and computer markets. To achieve our objectives, we are pursuing the following strategies:

Focus our product portfolio on targeted markets and growth opportunities where we can leverage our core expertise in analog and mixed-signal design, digital signal processing (DSP), firmware and software development, and our extensive applications knowledge to strengthen our market positions and expand market share.

Table of Contents

Capitalize on the depth of our global engineering talent and strength of our sales and marketing channels to expand into adjacent markets and provide innovative solutions to capture additional semiconductor content.

Leverage our strong customer base and expand strategic relationships with industry-leading OEMs/ODMs to maximize design wins.

Products and Markets

Our expertise in analog and mixed-signal processing, DSP, firmware and software, and applications knowledge allows us to deliver semiconductor devices and integrated systems for consumer electronics products. We organize our products to address opportunities in imaging, audio, embedded-modem, and video applications as more fully described below. We expect that our future products will focus on leveraging our imaging, audio, and video solutions to address technology convergence opportunities within the markets we address, and adjacent high-growth markets. We consider all products to fall into one class of products-semiconductor devices. We position our devices to address the following applications:

Imaging Applications. Our imaging product portfolio includes highly integrated multifunction printers (MFPs) system-on-chip (SoC) solutions for inkjet, laser, and photo printers, and high-performance system solutions for interactive display appliances with Internet connectivity. We also provide SoCs and datapumps for facsimile applications. We believe that our combined imaging intellectual property, MFP systems knowledge, and extensive firmware and software stacks uniquely position us to successfully address the increasing demand for printers that feature higher print speed, copy speed, and quality. Our current architecture also enables us to support the trend to PC independent printing, which we believe will allow us to capture additional market share as cloud computing printing and mobile printing spur future demand. We also expect to benefit from the trend at major OEM printer companies who currently design their own silicon to outsource MFP designs to merchant semiconductor providers.

Audio Applications. Over the last decade we have created an extensive intellectual property portfolio by developing advanced voice and audio algorithms running on a DSP. Our innovative technical algorithms include 3D expansion (phantom speaker), dynamic range compression, and stage enhancement (BrightSoundtm) that improve the consumer audio experience in small speakers that are used in products such as mobile Internet devices, portable media players, and smartphone docking stations. Our solutions include HD audio integrated circuits, and HD audio codecs with an integrated Class-D amplifier, which enables higher audio performance at lower power consumption. With the convergence of entertainment and communications applications, we expect the demand for audio solutions with integrated voice and audio functionality to grow significantly. To address this opportunity, we offer speakers-on-a-chip solutions for applications including PC speakers, audio subsystems, notebook docking stations, VoIP speakerphones, USB headsets supporting Microsoft Office Communicator and Skype, and surveillance applications, as well as for interactive display appliances and tablet PCs. We also provide audio solutions for notebook computers to OEMs and ODMs globally. In the first quarter of fiscal 2009, we strengthened our product portfolio by entering into an exclusive agreement with Analog Devices Inc. (ADI) to manufacture, distribute and support ADI s complementary PC audio codec product family.

Embedded-Modem Applications. We have a long history of technological innovation and leadership in modem technology, including the development of the world s first analog modem chip. Our analog modem solutions have connected hundreds of millions of users worldwide to the Internet through their desktop and notebook PCs. Today, the majority of our analog modem solutions are used in embedded applications, including television set-top boxes for back channel applications, point-of-sale (POS) terminals, home automation and security systems and various industrial applications.

Video Applications. We offer video decoders and media bridges for video surveillance/security and consumer video applications. Our highly integrated multi-port video decoders can be used in PC-based or standalone embedded digital video recording (DVR) applications. These products enable multi-channel, bi-directional uncompressed digital audio and video transfers to a host computer for preview, processing, or compression via an integrated PCI Express (PCIe) interface. Additional video products include system solutions for analog video-based multimedia applications including PCTV.

We introduced a new ASSP designed to provide the video processing for wireless cameras targeted at home security and monitoring. This product, with its low power and ease of use, is ideally suited for motion sensors with visual verification, intercoms, baby monitors, and various remote monitoring products. We will continue to evolve this line focused on enhanced video capabilities and low power, which will broaden our reach into the growing home security and monitoring markets and allow us to cover a broad range of applications from the very low-end monitoring and do-it-yourself security systems to commercial multi-channel DVRs.

Research and Development

We have significant research, development, engineering and product design capabilities. As of October 1, 2010, we had 319 employees engaged in research and development activities at multiple design centers worldwide as compared to 308 employees as of October 2, 2009 and 814 employees as of October 3, 2008. The significant decrease in employees reflects the reduction of approximately 355 employees in connection with our sale in August 2009 of our BBA business, as well as continued right-sizing efforts made throughout the fiscal year 2009.

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. Our major design centers are located in the United States. Additionally, we have integrated circuit design development activities in India and integrated circuit design, product and test engineering, and software support teams in China.

Our continuing operations incurred research and development expenses of $55.7 million, $51.4 million and $58.4 million during fiscal 2010, 2009 and 2008, respectively.

Manufacturing

We are a fabless semiconductor company, which means that we do not own or operate any wafer fabrication or assembly and test sites. We use several leading-edge wafer fabrication subcontractors, such as Taiwan Semiconductor Manufacturing Corporation (TSMC), to meet our typical planned production requirements. We have also qualified additional suppliers to meet short-term upside requirements as necessary during periods of tight capacity. We primarily use complementary metal-oxide semiconductor (CMOS) process technologies. Our products are manufactured in a variety of process technologies ranging from 0.8 micron technology, which is our most mature technology, to 90 nanometers, which is the most advanced production technology. We currently have product development efforts underway at the 65 nanometer process technology node, and are assessing the 40 nanometer technology for certain applications.

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 die are assembled into packages and the finished products are tested by subcontractors. Our primary wafer assembly and test subcontractors include Amkor Technology and STATSChipPAC Ltd. These vendors are located in Taiwan, Korea, Singapore, China, the Philippines and Malaysia. We use several different package types, tester platforms and handler configurations to fulfill our product needs at the key supplier sites.

Capacity is primarily obtained using a process of short- and long-term forecasting for suppliers to assess our demand, and committing supply to meet the forecasts. We maintain a strong presence at supplier sites to ensure our capacity needs are fulfilled adequately.

Quality and Reliability

Our quality and reliability assurance systems ensure that our products meet our customers and our internal product performance goals. Our quality management system maintains ISO 9001-2000 certification at our Newport Beach, California, facility. Our key suppliers are either already certified to ISO 9001 or have provided us with plans to achieve certification.

Our quality and reliability assurance department performs extensive environmental tests to demonstrate that our products meet our reliability performance goals. We use industry accepted environmental tests and test methods wherever practical during product qualification.

Table of Contents

In addition, our engineering and marketing organizations exercise extensive control during the definition, development and release to production of new products. We have a comprehensive set of design control procedures that:

- determine the quality, reliability and performance objectives for new products;
- provide program/project management, resource identification and facilities;
- ensure verification and validation activities;
- provide criteria for acceptability; and
- clearly define records that are necessary to provide confidence of conformity of the processes and resulting product to our quality system requirements.

We qualify all key suppliers (wafer foundries and assembly subcontractors) 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. 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 minimize the impact of potential problems.

We developed a Social and Environmental Management System (SEMS) that is used as a framework to develop and manage programs that prevent pollution, minimize the company s overall environmental impact, reduce health and safety risks, promote integrity and fair labor practice, and continually improve business practices and performance. Conexant s SEMS is certified to ISO 14001:2004 (International Organization for Standardization Environmental Management Systems) and conforms to the requirements of OHSAS 18001:2007 (Occupational Health and Safety Administration Standard Health and Safety Management Systems), and the EICC (Electronic Industry Citizenship Coalition Electronic Industry Code of Conduct).

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, channel partners, and resellers.

Sales to distributors and resellers accounted for approximately 24%, 36% and 34% of our net revenues in fiscal 2010, 2009 and 2008, respectively. In fiscal 2010, 2009 and 2008, there was one distributor, Sertek Incorporated, that accounted for 13%, 23% and 23% of our net revenues, respectively. Sales to our twenty largest customers accounted for approximately 82%, 87% and 83% of our net revenues in fiscal years 2010, 2009 and 2008, respectively.

Revenues derived from customers located in the Americas, the Asia-Pacific region and in Europe, the Middle East and Africa, as a percentage of total net revenues, were as follows:

	Fiscal Year Ended		
	2010	**2009**	**2008**
United States	6%	3%	3%
Other Americas	2%	1%	3%

China	60%	64%	64%
Taiwan	10%	7%	6%
Other Asia-Pacific	21%	24%	22%
Europe, Middle East and Africa	1%	1%	2%
Total foreign	94%	97%	97%
	100%	100%	100%

A portion of the products we sell to OEMs and third-party manufacturing service providers in China and the Asia-Pacific region are ultimately shipped to end markets in the Americas and Europe.

Table of Contents

We have a worldwide sales and marketing organization comprised of 129 employees as of October 1, 2010 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, resellers, 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.

See Item 1A, Risk Factors, in this report for a discussion of risks and uncertainties related to our international operations.

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 operate 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 Integrated Device Technology, Inc., LSI Corporation, Marvell Technology Group Ltd., Realtek Semiconductor Corporation, Silicon Laboratories, Inc., Intersil Corporation, Wolfson Microelectronics plc, and Zoran Corporation.

Intellectual Property and Proprietary Rights

We currently own over 800 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 licensed or 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. We believe that our intellectual property, including patents, patent applications, licenses and trademarks are of material importance to our business. We believe the duration of our intellectual property rights is adequate relative to the expected lives of our products. Due to the fast pace of innovation and product development, in certain cases our products may become obsolete before the patents, and other intellectual property rights, related to them expire. 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. We believe that any expenditure 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.

Table of Contents

Employees

As of October 1, 2010, we had 596 employees. 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.

Available Information

We maintain an Internet website at 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 stockholders 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 1A. *Risk Factors*

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

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

We are a much smaller company than in the recent past and dependent on fewer products for our success.

We are a much smaller company than in the recent past with a narrower, less diversified and more focused portfolio of products. Our smaller size could cause our cash flow and growth prospects to be more volatile and make us more vulnerable to focused competition. We will also have less capital available for research and development and for strategic investments and acquisitions. As a smaller company, we will be subject to greater revenue fluctuations if our older product lines sales were to decline faster than we anticipate. Moreover, we could also face greater challenges in satisfying or refinancing our debt obligations as they become due. In addition, we may not be able to appropriately restructure our supporting functions to fit the needs of a smaller company.

Our success depends on our ability to timely develop competitive new products to offset declines in our legacy products, increase market share, and reduce costs.

Our operating results depend largely on our ability to introduce new and enhanced semiconductor products on a timely basis to enable us to grow and to replace decreasing revenue from our established legacy products, which include wireless networking solutions, computer modems and modems for digital television platforms in Japan. 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;
- define accurately new products;
- complete development of new products and bring our products to market on a timely basis;
- differentiate our products from offerings of our competitors;
- achieve overall market acceptance of our products; and
- coordinate product development efforts between and among our sites, particularly in India and China, to manage the development of products at remote geographic locations.

We may not have sufficient resources to make the substantial investment in research and development in order to develop and bring to market new and enhanced products. 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. The complexity of our products may lead to errors, defects and bugs which could subject us to significant costs or damages and adversely affect market acceptance of our products. We also cannot assure you that we will be able to respond successfully to new product announcements and introductions by competitors.

The average selling prices of our established legacy products in our markets have historically decreased rapidly and will likely do so in the future, which could harm our revenue and gross profits.

Many of our products face significant competition and are subject to rapid declines in average selling prices over the life of the products. We have historically decreased the average selling prices of many of our products in order to meet market demand, and we expect that we will continue to reduce prices in the future. Reductions in our average selling prices to one customer could impact our average selling prices to all customers. A decline in average selling prices could harm our gross margins. Historically, we have generally been able to substantially offset reductions in our average selling prices with decreases in our product costs and increases in our unit volumes. Our financial results will suffer if we are unable to offset any future reductions in our average selling prices by increasing our unit volumes, reducing our costs or developing new or enhanced products on a timely basis with higher selling prices or gross profit. While gross profit may decline as a result of reductions in average selling prices, we may continue to incur research and development costs at higher or existing levels to develop future products. This continued spending would have an adverse impact on our immediate operating results if our revenue does not continue to grow or our gross margins decline.

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 U.S. and international semiconductor providers that are both larger and smaller than us in terms of resources and market share. We continually face significant competition in our markets. This competition results 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, technological and public policy changes and relatively low barriers to entry in certain markets of the industry. 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.

In addition, the financial stability of suppliers is an important consideration in our customers purchasing decisions. Many of our competitors have certain advantages over us, such as significantly greater sales and marketing, manufacturing, distribution, technical, financial and other resources. In addition, many of our current and potential competitors have a stronger financial position, less indebtedness and greater financial resources than we do. These competitors may be able to devote greater financial resources to the development, promotion and sale of their products than we can. Our relationship with existing and potential customers could be adversely affected if our customers perceive that we lack an appropriate level of financial liquidity or stability or if they think we are too small to do business with.

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.

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

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles (for semiconductors and for the end-user products in which they are used) and wide fluctuations in product supply and demand. Recent domestic and global economic weakness and uncertainty have presented unprecedented and challenging conditions reflecting continued concerns about the availability and cost of credit, the U.S. mortgage market, declining real estate values, increased energy costs, decreased consumer confidence and spending and added concerns fueled by the U.S. federal government s interventions in the U.S. financial and credit markets. These conditions have contributed to instability in both U.S. and international capital and credit markets and diminished expectations for the U.S. and global economy. In addition, these conditions make it extremely difficult for our customers to accurately forecast and plan future business activities and could cause U.S. and foreign businesses to slow spending on our products, which could cause our sales to decrease or result in an extension of our sales cycles. Further, given uncertainty in the economic environment, our customers may have difficulties obtaining capital at adequate or historical levels to finance their ongoing business and operations, which could impair their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our days sales outstanding would be negatively impacted. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide or within our industry. If the economy or markets in which we operate continue to be subject to these adverse economic conditions, our business, financial condition, cash flow and results of operations will be adversely affected.

Since we have limited visibility as to the volume of sales of our products by our customers and inventory levels of our products held by our customers, our ability to forecast accurately future demand for and sales of our products is limited.

We sell our chipsets to OEMs, who integrate our chipsets into their products, or to ODMs who include our chipsets in the products they supply to OEMs. We have limited visibility as to the volume of our products that our OEM and ODM customers are selling to their customers or carrying in their inventory. If our customers have excess inventory or experience a slowing of products sold through to their end customers, it would likely result in a slowdown in orders from our customers and adversely impact our future sales and inventory.

Our products typically have lengthy sales cycles. A customer may decide to cancel or change its product plans, which could cause us to lose anticipated sales and we may incur significant expenses before we generate any revenues

After we have developed and delivered a product to a customer, the customer will usually evaluate our product prior to designing its own equipment to incorporate our product. Our customers may need several months to test, evaluate and choose whether to adopt our product, and to begin volume production of equipment that incorporates our product. Due to these lengthy sales cycles, we may experience significant delays from the time we incur certain research and development costs, selling, general and administrative expenses, and build initial inventory, until the time we generate revenue from these products. It is possible that we may never generate any revenue from these products after incurring such expenditures. Even if a customer selects our solution to incorporate into its product, we have no assurances that the customer will ultimately market and sell its product or that such efforts by our customer will be successful. The delays inherent in our lengthy sales cycle also increase the risk that a customer will decide to cancel or curtail, reduce or delay its product plans. Such a cancellation or change in plans by a customer could cause us to lose sales that we had anticipated.

We will continue to expend substantial resources developing products for new applications or markets and may never achieve the sales volume that we anticipate for these products, which may limit our future growth and harm our results of operations.

We have focused our R&D investments in Imaging, Audio and Video areas. Through the acquisition of the Sigmatel MFP business in 2008, and the purchase of assets and certain liabilities of the ADI audio business in 2009 and our internal development efforts, we have increased our sales in these application areas. Although we plan to continue to drive growth in these applications and other new areas, we still have a significant portion of revenue coming from our legacy modem businesses. Our future success will depend in part upon our ability to offer products outside of this legacy business, and we face a number of risks in connection with these products, including those described in other risk factors in this report. We have in the past, and will likely in the future, expend substantial resources in developing new and additional products for new applications and markets. We may experience unforeseen difficulties and delays in developing these products and defects upon volume production and broad deployment. In addition, we will have limited experience in these new markets, and we may be unsuccessful in marketing and selling any products we develop for these or other new markets. The markets we choose to enter will likely be highly competitive and many of our competitors will have substantially more experience in these markets. Our success will depend on the growth of the markets we enter, the competitiveness of our products and our ability to increase our market share in these markets. If we choose to enter markets that do not achieve or sustain the growth we anticipate, or if our products are not competitive, we may not achieve volume sales, which may limit our future growth and would harm our results of operations.

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. In addition, if a second source supplier becomes available to a key customer for whom we are the sole supplier, our revenue from that key customer 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 20 largest customers, including distributors, represented approximately 82%, 87% and 83% of our net revenues in fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, respectively. For fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, one distributor accounted for 13%, 23% and 23% of our net revenues, respectively. We expect that our largest customers will continue to account for a substantial portion of our net revenue in future periods. The identities of our largest customers and their respective contributions to our net revenue have varied and will likely continue to vary from period to period. We may not be able to maintain or increase sales to certain of our key customers for a variety of reasons, including the following:

- most of our customers can stop incorporating our products into their own products with limited notice to us and suffer little or no penalty;
- our agreements with our customers typically do not require them to purchase a minimum quantity of our products;
- our customers perceptions of our liquidity and viability may have a negative impact on their decisions to incorporate our products into their own 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;
- some of our customers offer or may offer products that compete with our products;
- some of our customers liquidity may be negatively affected by continued uncertainty in global economic conditions; and
- our small size, our cost-savings efforts and any future liquidity constraints may limit our ability to develop and deliver new products to customers.

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.

Further, our product portfolio consists predominantly of semiconductor solutions for the communications, PC, and consumer markets. Recently, unfavorable domestic and global economic conditions have had an adverse impact on demand in these end-user markets by reducing overall consumer spending or shifting consumer spending to products other than those made by our customers. Any prolonged or significant decrease in consumer spending by customers in these end-markets will adversely impact demand by our customers for our products and could also slow new product introductions by our customers and by us. Lower net sales of our products would have an adverse effect on our revenue, cash flow and results of operations.

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 the markets we operate in 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;
- evolving industry standards; and
- constant transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries, increased expenses and loss of design wins to our competitors.

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.

If OEMs of 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 components of other products. As a result, we rely on OEMs of 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.

Our operating and financial flexibility is limited by the terms of the agreement governing our accounts receivable financing facility and the terms of the indenture governing our senior secured notes due 2015.

The agreement governing our accounts receivable financing facility and the indenture governing our senior secured notes due 2015 contain financial and other covenants that may limit our ability to take, or prevent us from taking, certain actions that we believe are in the best interests of our business and our stockholders. For example, the indenture governing our senior secured notes contains covenants that restrict, subject to certain exceptions, our ability and the ability of our subsidiaries who are guarantors of our senior secured notes to incur or guarantee additional indebtedness or issue certain redeemable or preferred stock; repurchase capital stock; pay dividends on or make other distributions in respect of our capital stock or make other restricted payments; make certain investments; create liens; redeem junior debt; sell certain assets; consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; enter into certain types of transactions with affiliates; and enter into sale-leaseback transactions. In addition, we are required to use the proceeds of certain asset dispositions to offer to repurchase our senior secured notes if we do not use the proceeds within 360 days to invest in assets (other than current assets) to be used in our business; and this requirement limits our ability to use asset sale proceeds to fund our operations. The restrictions imposed by the agreement governing our accounts receivable financing facility and the indenture

Table of Contents

governing our senior secured notes may prevent us from taking actions that could help to grow our business or increase the value of our securities.

We are subject to the risks of doing business internationally.

For the fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, net revenues from customers located outside of the United States (U.S.), primarily in the Asia-Pacific region, represented approximately 94%, 97% and 97%, respectively, of our total net revenues. In addition, many of our key suppliers are located outside of the U.S. Our international operations consist of research and development, sales offices, and other general and administrative functions. Our international operations are subject to a number of risks inherent in operating abroad. These include, but are not limited to, risks regarding:

- difficulty in obtaining distribution and support;
- local economic and political conditions;
- limitations on our ability under local laws to protect our intellectual property;
- currency exchange rate fluctuations;
- disruptions of commerce and capital or trading markets due to or related to terrorist activity, armed conflict, or natural disasters;
- 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;
- the laws and policies of the U.S. and other countries affecting trade, foreign investment and loans, and import or export licensing requirements; and
- tax laws, including the cost of services provided and products sold between us and our subsidiaries which are subject to review by taxing authorities.

Further, because most of our international sales are currently denominated in U.S. dollars, our products could become less competitive in international markets if the value of the U.S. dollar increases relative to foreign currencies. From time to time, we may enter into foreign currency forward exchange contracts to minimize risk of loss from currency exchange rate fluctuations for foreign currency commitments entered into during the ordinary course of business. We have not entered into foreign currency forward exchange contracts for other purposes. As of October 1, 2010, we did not have any outstanding foreign currency exchange contracts. 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 24%, 36% and 34% of our net revenues for the fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, respectively. Our arrangements with these distributors are terminable at any time, and the loss of these arrangements could have an adverse effect on our operating results.

Our success depends, in part, on our ability to effect suitable investments, alliances, acquisitions and where appropriate, divestitures and restructurings.

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:

- write-offs of in-process research and development;
- the incurrence of substantial debt and assumption of unknown liabilities;

the potential loss of key employees from the acquired company;

amortization expenses related to intangible assets; and

the diversion of management s attention from other business concerns.

Integrating acquired organizations and their products and services may be expensive, time-consuming and a strain on our resources and our relationships with employees and customers, and ultimately may not be successful. The process of integrating operations could cause an interruption of, or loss of momentum in, the activities of one or more of our products 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.

Moreover, in the event that we have unprofitable operations or products, we may be forced to restructure or divest such operations or products. There is no guarantee that we will be able to restructure or divest such operations or products on a timely basis or at a value that will avoid further losses or that will successfully mitigate the negative impact on our overall operations or financial results.

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 24%, 36% and 34% of our net revenues for the fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, 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 suppliers products and may not sell our products as quickly as forecasted, which may impact the distributors 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.

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

We are entirely dependent upon outside wafer fabrication facilities (known as foundries or fabs). Therefore, our revenue growth is dependent on our ability to obtain sufficient external manufacturing capacity, including wafer fabrication capacity. If the semiconductor industry experiences a shortage of wafer fabrication capacity in the future, we risk experiencing delays in access to key process technologies, production or shipments and increased manufacturing costs. Moreover, our foundry partners often require significant amounts of financing in order to build or expand wafer fabrication facilities. However, current uncertain economic conditions have also resulted in a tightening in the credit markets, decreased the level of liquidity in many financial markets and resulted in significant volatility in the credit and equity markets. These conditions may make it difficult for foundries to obtain adequate or historical levels of capital to finance the building or expansion of their wafer fabrication facilities, which would have an adverse impact on their production capacity and could in turn negatively impact our wafer output. In addition, certain of our suppliers have required that we keep in place standby letters of credit for all or part of the products we order. Such requirement, or a requirement that we pre-pay for all or part of vendor invoices or that we shorten our payment cycle times in the future, may negatively impact our liquidity and cash position, or may not be available to us due to our then-current liquidity or cash position, and would have a negative impact on our ability to produce and deliver products to our customers on a timely basis.

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 testing of our products. Our reliance on others to assemble and test our products subjects us to many of the same risks that we have with respect to our reliance on outside foundries. Wafer fabrication processes are subject to obsolescence, and foundries may discontinue a 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 that product. The unanticipated discontinuation of wafer fabrication processes on which we rely may adversely affect our revenues and our customer relationships.

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 fabrication capacity, may not be available to us on a timely basis. Even if alternate wafer fabrication capacity is available, we may not be able to obtain it on favorable terms, or at all. All such delays or disruptions 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 and may adversely affect our cost of goods sold and our results of operations.

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

We use a significant amount of intellectual property in our business. We rely primarily on patent, copyright, trademark and trade secret laws, as well as nondisclosure and confidentiality agreements and other methods, to protect our proprietary technologies and processes. At times, we incorporate intellectual property licensed from our customers and other third parties 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.

A significant portion of our intellectual property rights is located in foreign jurisdictions. Because of the differences in foreign patent, trademark and other laws concerning proprietary rights, our intellectual property rights frequently do not receive the same degree of protection in foreign jurisdictions as they would in the U.S. Our failure to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business, results of operations and financial condition.

Table of Contents

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

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

- pay substantial damages;
- cease the manufacture, use or sale of infringing products, processes or technologies;
- discontinue the use of infringing technology;
- expend significant resources to develop non-infringing technology, which we may not be successful in developing; or
- license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all.

The price of our common stock may fluctuate significantly, which may make it difficult for you to resell your common stock when you want or at prices you find attractive.

The price of our common stock is volatile and may fluctuate significantly. For example, since September 29, 2007, the price of our stock has ranged from a high of $14.80 per share to a low of $0.26 per share. We cannot assure you as to the prices at which our common stock will trade or that an active trading market in our common stock will be sustained in the future. In addition to the matters discussed in other risk factors included herein, some of the reasons for fluctuations in our stock price could include:

- our operating and financial performance and prospects;
- the depth and liquidity of the market for our common stock;
- investor perception of us and the industry in which we operate;
- the level of research coverage of our common stock;
- changes in earnings estimates or buy/sell recommendations by analysts;
- general financial, domestic, international, economic and other market conditions;
- proposed acquisitions by us or our competitors;

the hiring or departure of key personnel; and

adverse judgments or settlements obligating us to pay damages.

In addition, public stock markets have experienced, and may in the future experience, extreme 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 own or lease a significant amount of space in which we do not conduct operations, and doing so exposes us to the financial risks of default by our tenants and subtenants and expenses related to carrying vacant property.

As a result of our various reorganization and restructuring related activities, we lease or own a number of domestic facilities in which we do not operate. At October 1, 2010, we had 407,175 square feet of leased space and 456,000 square feet of owned space, of which approximately 89% was being leased to third parties and 11% was vacant and offered for lease. Included in these amounts are 389,000 square feet of owned space in Newport Beach, California that we have leased to TowerJazz (formerly Jazz Semiconductor, Inc.). As of October 1, 2010, the aggregate amount owed to landlords under space we lease but do not operate over the remaining terms of the leases was approximately $56.0 million and, of this amount, subtenants had lease obligations to us in the aggregate amount of $13.7 million. The space we have subleased to others is, in some cases, at rates less than the amounts we are required to pay landlords and, of the aggregate obligations we had to landlords for unused space at October 1, 2010, approximately $7.0 million was attributable to space we were attempting to sublease. In the event one or more of our subtenants fails to make lease payments to us or otherwise defaults on their obligations to us, we could incur substantial unanticipated payment obligations to landlords. In addition, in the event tenants of space we own fail to make lease payments to us or otherwise default on their obligations to us, we could be required to seek new tenants and we cannot assure you that our efforts to do so would be successful or that the rates at which we could do so would be attractive. In the event our estimates regarding our ability to sublet our available space are incorrect, we would be required to adjust our restructuring reserves, which could have a material impact on our financial results in the future.

We have historically incurred substantial losses and may incur additional future losses.

Our loss from continuing operations (as retrospectively adjusted) for the fiscal years ended October 2, 2009 and October 3, 2008 was $40.5 million and $12.7 million, respectively. These results have had a negative impact on our financial condition and operating cash flows. We cannot assure you that our business will be profitable or that we will not incur additional substantial losses in the future. Additional operating losses or lower than expected product sales will adversely affect our cash flow and financial condition and could impair our ability to satisfy our indebtedness obligations as such obligations come due.

The value of our warrant to purchase 6.1 million shares of Mindspeed common stock is subject to material increases and decreases in value based on factors beyond our control.

We have a warrant to purchase approximately 6.1 million shares of Mindspeed common stock at an exercise price of $16.74 per share through June 2013. At October 1, 2010 and October 2, 2009, the market value of Mindspeed common stock was $7.73 and $3.05 per share, respectively. We account for the Mindspeed warrant as a derivative instrument, and changes in the fair value of the warrant are included under other expense (income), net in the statement of operations for each period. At October 1, 2010 and October 2, 2009, the aggregate fair value of the Mindspeed warrant included on the accompanying consolidated balance sheets was $20.7 million and $5.1 million, respectively. At October 1, 2010, the warrant was valued using the Black-Scholes-Merton model with an expected term of 2.75 years, expected volatility of 101%, risk-free interest rate of 0.58% and no dividend yield. The aggregate fair value of the warrant is reflected as a long-term asset on the accompanying consolidated balance sheets because we do not intend to liquidate any portion of the warrant in the next twelve months. At October 1, 2010 and October 2, 2009, the value of the warrant represented 7% and 1%, respectively, of total assets.

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. We could, at any point in time, ultimately realize amounts significantly different than the carrying value.

Table of Contents

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

Our future success depends on our ability to attract and to retain the continued service and availability of skilled personnel at all levels of our business. 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. 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.

Litigation could be costly and harmful to our business.

We are involved in various claims and lawsuits from time to time. For example, in February 2005, certain of our current and former officers and our Employee Benefits Plan Committee were named as defendants in a purported breach of fiduciary duties class action lawsuit that we recently settled for $3.25 million. Any of these claims or legal actions could adversely affect our business, financial position and results of operations and divert management s attention and resources from other matters.

If any of the tax holidays or favorable tax incentives under which we operated in certain foreign jurisdictions are disallowed, our results of operations may be materially and adversely affected.

We operated under tax holidays and favorable tax incentives in certain foreign jurisdictions. While we believe we qualified for these incentives that reduced our income taxes and operating costs, the incentives required us to meet specified criteria, which are subject to audit and review. We cannot assure you that we met such criteria that would enable us to enjoy such tax holidays and incentives or realize any tax benefits from the tax holidays and incentives. If any of our tax holidays or incentives are terminated, our results of operations may be materially and adversely affected.

Our ability to use our net operating losses (NOLs) and other tax attributes to offset future taxable income could be limited by an ownership change and/or decisions by California and other states to suspend the use of NOLs.

We have significant NOLs, R&D tax credits, capitalized R&D and amortizable goodwill available to offset our future U.S. federal and state taxable income. A significant amount of our NOLs were acquired in the acquisition of certain of our subsidiaries. Those NOLs are subject to limitations imposed by Section 382 of the Internal Revenue Code (and applicable state law). In addition, our ability to utilize any of our NOLs and other tax attributes may be subject to significant limitations under Section 382 of the Internal Revenue Code (and applicable state law) if we undergo an ownership change. An ownership change occurs for purposes of Section 382 of the Internal Revenue Code if, among other things, 5% stockholders (i.e., stockholders who own or have owned 5% or more of our stock (with certain groups of less-than-5% stockholders treated as single stockholders for this purpose)) increase their aggregate percentage ownership of our common stock by more than fifty percentage points above the lowest percentage of the stock owned by these stockholders at any time during the relevant testing period. Stock ownership for purposes of Section 382 of the Internal Revenue Code is determined under a complex set of attribution rules, so that a person is treated as owning stock directly, indirectly (i.e., through certain entities) and constructively (through certain related persons and certain unrelated persons acting as a group). In the event of an ownership change, Section 382 imposes an annual limitation (based upon our value at the time of the ownership change, as determined under Section 382 of the Internal Revenue Code) on the amount of taxable income a corporation may offset with NOLs. If we undergo an ownership change, Section 383 would also limit our ability to use R&D tax credits. In addition, if the tax basis of our assets exceeded the fair market value of our assets at the time of the ownership change, Section 382 could also limit our ability to use amortization of capitalized R&D and goodwill to offset taxable income for the first five years following an ownership change. Any unused annual limitation may be carried over to later years until the applicable expiration date for the respective NOLs. As a result, our inability to utilize these NOLs, credits or amortization as a result of any ownership changes could adversely impact our operating results and financial condition.

In addition, California and certain states have suspended use of NOLs and credits for certain taxable years, and other states are considering similar measures. As a result, we may incur higher state income tax expense in the future. Depending on our future tax position, continued suspension of our ability to use NOLs, credits and tax attributes in states in which we are subject to income tax could have an adverse impact on our operating results and financial condition.

In the event of a change of control, we may not be able to repurchase our outstanding debt as required by the applicable indenture, which would result in a default under the indenture.

Upon a change of control, we will be required to offer to repurchase all of our senior notes at 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the applicable repurchase date. As of October 1, 2010, the aggregate outstanding principal amount of the senior notes was $175.0 million. Future debt agreements may contain similar provisions. We may not have the financial resources to repurchase our indebtedness.

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

At October 1, 2010, we had $109.9 million of goodwill and $4.3 million of intangible assets, net, which together represented approximately 37% of our total assets. In periods subsequent to an acquisition, at least on an annual basis or when indicators of impairment exist, we must evaluate goodwill and acquisition-related intangible assets for impairment. When such assets are found to be impaired, they will be written down to estimated fair value, with a charge against earnings. If our market capitalization drops below our book value for a prolonged period of time, our assumptions regarding our future operating performance change or other indicators of impairment are present, we may be required to write-down the value of our goodwill and acquisition-related intangible assets by taking a charge against earnings.

Our remaining goodwill is associated with our business. Goodwill is tested at the reporting unit level annually in the fourth fiscal quarter and, if necessary, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. During the fourth fiscal quarter of 2010, we determined that the fair value of our business was greater than its carrying value and therefore there was no impairment of goodwill as of October 1, 2010. Because of the significance of our remaining goodwill and intangible asset balances, any future impairment of these assets could have a material adverse effect on our financial condition and results of operations, although, as a charge, it would have no effect on our cash flow. Significant impairments may also impact shareholders equity (deficit).

Our revenues, cash flow from operations and results of operations have fluctuated in the past and may fluctuate in the future, particularly given uncertain domestic and global economic conditions.

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

- changes in end-user demand for the products manufactured and sold by our customers;
- the timing of receipt, reduction or cancellation of significant orders by customers;
- adverse economic conditions, including the unavailability or high cost of credit to our customers;
- the inability of our customers to forecast demand based on uncertain economic conditions;

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;

Table of Contents

- 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 effect 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 business, financial condition, cash flow and results of operations.

Item 1B. ***Unresolved Staff Comments***

Not applicable.

Item 2. ***Properties***

Our corporate headquarters are located in Newport Beach, California. Our other principal facility in the United States is located in Waltham, Massachusetts. Activities at these locations include research and development (including design centers) and operations functions. We also have facilities in India and China. The following table summarizes the locations and respective square footage of the facilities in which we operated at October 1, 2010 (square footage in thousands):

	Leased Square Footage	Owned Square Footage	Total
United States:			
Newport Beach, California	106	51	157
Waltham, MA	29		29
	135	51	186
India	20		20
China	27		27
Other Asia	37		37
Europe	3		3
	222	51	273

As a result of our various reorganization and restructuring-related activities, we also lease or own a number of domestic facilities in which we do not operate. At October 1, 2010, we had 407,175 square feet of leased space and 456,000 square feet of owned space, of which approximately 89% was being leased to third parties and 11% was vacant and offered for lease. Included in these amounts are 389,000 square feet of owned space in Newport Beach that we have leased to TowerJazz (formerly Jazz Semiconductor, Inc.).

We own approximately 25 acres of land in Newport Beach, California, including the land on which our 456,000 square feet of owned space is located. We have determined that approximately 17 acres of this property currently zoned for light industrial use could be sold and/or re-developed under the current provisions of our lease agreement with TowerJazz. Under the passage of a new general plan for the City of Newport Beach in November 2006, we initiated efforts to re-zone the property for mixed use (e.g., residential, retail, etc.) and secure entitlements to maximize the value of this land. On September 28, 2010, the Newport Beach City Council unanimously approved our conceptual mixed use (residential/commercial) development plan. This approval is the first step in obtaining the City of Newport Beach s final entitlement approvals specific to our land. An exact date for when the entitlements will be completed is still unclear but efforts continue with the City of Newport Beach.

In November 2009, we committed to a plan for the sale of certain of this property located on Jamboree Road adjacent to our Newport Beach headquarters. We have retained a broker to solicit bids from potential buyers for the land. A buyer would be selected based upon their ability to acquire our land in the current real estate market. These marketing and sales efforts are continuing.

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. In addition, certain of our facilities are located in countries that may experience civil unrest.

Item 3. ***Legal Proceedings***

None

Item 4. ***Reserved***

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 Global Select Market under the symbol CNXT . The following table lists the high and low intra-day sale prices for our common stock as reported by the NASDAQ Global Select Market for the periods indicated:

	High	Low
Fiscal year ended October 1, 2010:		
Fourth quarter	$ 2.48	$ 1.38
Third quarter	4.20	2.02
Second quarter	5.17	2.30
First quarter	3.31	2.04
Fiscal year ended October 2, 2009:		
Fourth quarter	$ 3.95	$ 1.11
Third quarter	1.74	0.68
Second quarter	0.86	0.26
First quarter	3.35	0.64

At October 29, 2010, there were approximately 27,234 holders of record of our common stock.

We have never paid cash dividends on our common stock. We are also currently prohibited from paying cash dividends under the terms of our senior secured notes indenture. Accordingly, 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.

Table of Contents

Shareowner Return Performance Graph

Set forth below is a line graph comparing the cumulative total shareowner return on our common stock against the cumulative total return of the Standard & Poor s 500 Stock Index and the Nasdaq Electronic Components Index for the five-year period ended October 1, 2010. The graph assumes that $100 was invested in each of our common stock, the Standard & Poor s 500 Stock Index and the Nasdaq Electronic Components Index at the respective closing prices on September 30, 2005, the last trading day before the beginning of our fifth preceding fiscal year and that all dividends were reinvested, and is adjusted to give effect to our June 30, 2008 reverse stock split. No cash dividends have been paid or declared on our common stock.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Conexant Systems, Inc., The S&P 500 Index
And The NASDAQ Electronic Components Index

* $100 invested on 9/30/05 in stock or index, including reinvestment of dividends.
Fiscal year ending Friday nearest to September 30 of each year.

	9/05	9/06	9/07	9/08	9/09	9/10
Conexant Systems, Inc.	100.00	111.73	67.04	22.40	15.31	9.16
S&P 500	100.00	110.79	129.01	100.66	93.70	103.22
NASDAQ Electronic Components	100.00	95.01	114.47	80.09	86.57	91.20

Table of Contents

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

On October 3, 2009, the Company adopted the accounting guidance for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The provisions of the accounting guidance were retrospectively applied, and all prior period amounts have been adjusted to apply the method of accounting.

In August 2009, the Company completed the sale of its Broadband Access (BBA) business to Ikanos Communications, Inc. and in August 2008, the Company completed the sale of its Broadband Media Processing (BMP) business unit to NXP B.V. The selected financial data for all periods have been restated to reflect the BMP and BBA businesses as discontinued operations.

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.

	Fiscal Year Ended				
	2010	**2009**	**2008**	**2007**	**2006**
	(In thousands, except per share amounts)				
Statement of Operations Data:					
Net revenues	$ 240,726	$ 208,427	$ 331,504	$ 360,703	$ 485,571
Cost of goods sold(1)	94,157	86,674	137,251	161,972	223,809
Gain on cancellation of supply agreement(2)					(17,500)
Gross margin	146,569	121,753	194,253	198,731	279,262
Operating expenses:					
Research and development(1)	55,745	51,351	58,439	91,885	101,274
Selling, general and administrative(1)	48,249	62,740	77,905	80,893	89,863
Amortization of intangible assets	1,249	2,976	3,652	9,555	18,450
Gain on sale of intellectual property(3)		(12,858)			
Asset impairments(4)		5,672	277	225,380	85
Special charges(5)	837	18,983	18,682	8,360	3,731
Total operating expenses	106,080	128,864	158,955	416,073	213,403
Operating income (loss)	40,489	(7,111)	35,298	(217,342)	65,859
Interest expense	30,072	34,693	40,713	48,798	39,540
Other (income) expense, net	(12,455)	(5,025)	9,223	(36,505)	14,281
Income (loss) from continuing operations before income taxes and (loss) gain on equity method investments	22,872	(36,779)	(14,638)	(229,635)	12,038
Provision for income taxes	567	871	849	798	889
Income (loss) from continuing operations before (loss) gain on equity method	22,305	(37,650)	(15,487)	(230,433)	11,149

investments					
(Loss) gain on equity method investments	(66)	(2,807)	2,804	51,182	(8,164)
Income (loss) from continuing operations	22,239	(40,457)	(12,683)	(179,251)	2,985
Gain on sale of discontinued operations, net of tax(6)		39,170	6,268		
Loss from discontinued operations, net of tax(1)(6)	(2,005)	(17,521)	(306,670)	(235,056)	(132,549)
Net income (loss)	$ 20,234	$ (18,808)	$ (313,085)	$ (414,307)	$ (129,564)

24

Table of Contents

	Fiscal Year Ended 2010	2009	2008	2007	2006
	(In thousands, except per share amounts)				
Income (loss) per share from continuing operations basic	$ 0.31	$ (0.81)	$ (0.26)	$ (3.67)	$ 0.06
Income (loss) per share from continuing operations diluted	$ 0.30	$ (0.81)	$ (0.26)	$ (3.67)	$ 0.06
Gain per share from sale of discontinued operations basic and diluted	$ 0.00	$ 0.78	$ 0.13	$ 0.00	$ 0.00
Loss per share from discontinued operations basic	$ (0.03)	$ (0.35)	$ (6.21)	$ (4.80)	$ (2.76)
Loss per share from discontinued operations diluted	$ (0.03)	$ (0.35)	$ (6.21)	$ (4.80)	$ (2.71)
Net income (loss) per share basic	$ 0.28	$ (0.38)	$ (6.34)	$ (8.47)	$ (2.70)
Net income (loss) per share diluted	$ 0.27	$ (0.38)	$ (6.34)	$ (8.47)	$ (2.65)

Balance Sheet Data at Fiscal Year End:

	2010	2009	2008	2007	2006
			(In thousands)		
Working capital(7)	$ 79,472	$ 42,047	$ 115,617	$ 318,360	$ 127,635
Total assets	305,844	350,201	445,284	984,365	1,571,544
Short-term debt	10,978	28,653	40,117	80,000	80,000
Current portion of long-term debt		61,400	17,707	58,000	188,375
Long-term obligations	230,740	290,667	394,597	474,591	540,035
Shareholders equity (deficit)	12,092	(97,778)	(102,416)	193,742	569,170

(1) Stock-based compensation expense included within cost of goods sold, research and development expense, and selling, general and administrative expense in fiscal 2010, 2009, 2008, 2007 and 2006 is based on the fair value of all stock options, stock awards and employee stock purchase plan shares. Non-cash employee stock-based compensation expense included in our consolidated statements of operations was as follows (in thousands):

	Fiscal Year Ended 2010	2009	2008	2007	2006
	(In thousands)				
Cost of goods sold	$ 298	$ 247	$ 370	$ 426	$ 382
Research and development	1,681	869	2,725	6,157	9,249
Selling, general and administrative	4,700	3,736	9,185	7,271	19,312
Loss from discontinued operations, net of tax	(30)	868	3,589	5,897	16,632

(2) In fiscal 2006, Conexant and Jazz Semiconductor, Inc. (Jazz) terminated a wafer supply and services agreement. In lieu of credits towards future purchases of product from Jazz, we received additional shares of Jazz common stock and recorded a gain of $17.5 million.

(3) In fiscal 2009, we recorded a $12.9 million gain on sale of intellectual property.

(4) In fiscal 2007, we recorded $184.7 million of goodwill impairment charges, $30.3 million of intangible impairment charges and $6.1 million of property, plant and equipment impairment charges associated with our Embedded Wireless Network products.

Table of Contents

(5) Special charges include the following related to the settlement of legal matters and restructuring charges, among others (in thousands):

	Fiscal Year Ended				
	2010	2009	2008	2007	2006
	(In thousands)				
Legal settlements	$ 589	$ 3,475	$	$ 1,497	$
Restructuring charges	(282)	15,116	11,539	7,227	3,641

(6) As a result of our decision to sell certain assets and liabilities of the BMP and BBA business units in fiscal 2008 and 2009, respectively, the results of the BMP and BBA business and the gain on sale of the BMP business are reported as discontinued operations for all periods presented.

(7) Working capital is defined as current assets minus current liabilities.

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

You should read the following discussion and analysis in conjunction with our Consolidated Financial Statements and related Notes thereto included in Part II, Item 8 of this report and the Risk Factors included in Part I, Item 1A of this report, as well as other cautionary statements and risks described elsewhere in this report.

Overview

We design, develop and sell semiconductor system solutions, comprised of semiconductor devices, software and reference designs, for imaging, audio, embedded-modem, and video applications. These solutions include a comprehensive portfolio of imaging solutions for multifunction printers (MFPs), fax platforms, and interactive display frame market segments. Our audio solutions include high-definition (HD) audio integrated circuits, HD audio codecs, and speakers-on-a-chip solutions for personal computers, PC peripheral sound systems, audio subsystems, speakers, notebook docking stations, voice-over-IP speakerphones, USB headsets supporting Microsoft Office Communicator and Skype, and audio-enabled surveillance applications. We also offer a full suite of embedded-modem solutions for set-top boxes, point-of-sale systems, home automation and security systems, and desktop and notebook PCs. Additional products include decoders and media bridges for video surveillance, security and monitoring applications, and system solutions for analog video-based multimedia applications.

Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday closest to September 30. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal years 2010 and 2009 were 52-week years and ended on October 1, 2010 and October 2, 2009, respectively. Fiscal year 2008 was a 53-week year and ended on October 3, 2008.

Sale of Property

In November 2009, we committed to a plan for the sale of certain of our property located on Jamboree Road adjacent to our Newport Beach, California headquarters. The property consists of an approximately 25-acre site, including two leased buildings, certain personal property on the site, and all easements and other intangible rights appurtenant to the property. We determined that this property met the criteria for held for sale in accordance with the accounting guidance for impairment or disposal of long-lived assets and have presented the respective group of assets separately on the consolidated balance sheet as of October 1, 2010.

Discontinued Operations

Broadband Access Business

In August 2009, we completed the sale of our Broadband Access (BBA) business to Ikanos Communications, Inc. (Ikanos). The results of the BBA business have been reported as discontinued operations in the consolidated statements of operations for all periods presented.

Table of Contents

Broadband Media Processing Business

In August 2008, we completed the sale of our Broadband Media Processing (BMP) business to NXP B.V. (NXP). The results of the BMP business have been reported as discontinued operations in the consolidated statements of operations for all periods presented.

We anticipate continuing to accumulate pretax losses in discontinued operations due to accretion on lease liability from a restructured facility related to the BMP business.

Business Enterprise Segments

We operate in one reportable segment, the semiconductor system solutions market. Based on the accounting guidance in accordance with Segment Reporting, public business enterprises must report information about operating segments in their annual consolidated financial statements. Following our sale of the BBA operating segment, the results of which have been classified in discontinued operations, we have one remaining operating segment, comprised of one reporting unit, which was identified based upon the availability of discrete financial information and the chief operating decision makers regular review of the financial information for this operating segment. Additional geographic segment reporting information is included in Note 16 to consolidated financial statements in this report.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among the significant estimates affecting our consolidated financial statements are those relating to revenue recognition, allowances for doubtful accounts, sales returns and allowances, warranty reserves, inventory reserves, stock-based compensation expense, goodwill and purchased intangible asset valuations, valuation of warrants and strategic investments, deferred income tax asset valuation allowances, uncertain tax positions, restructuring costs, and other loss contingencies. We regularly evaluate our estimates and assumptions based upon historical experience and various other factors that we believe to be reasonable under the circumstances. The results of our estimates and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent actual results differ from those estimates, our future results of operations may be affected.

Revenue recognition

We recognize revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the sales price and terms are fixed and determinable, and (iv) the collection of the receivable is reasonably assured. These terms are typically met upon shipment of product to the customer. The majority of our distributors have limited stock rotation rights, which allow them to rotate up to 10% of product in their inventory two times per year. We recognize revenue to these distributors upon shipment of product to the distributor, as the stock rotation rights are limited and we believe that we have the ability to reasonably estimate and establish allowances for expected product returns in accordance with accounting guidance for revenue recognition when right of return exists. Development revenue is recognized when services are performed and was not significant for any periods presented.

Revenue with respect to sales to customers, to whom we have significant obligations after delivery, is deferred until all significant obligations have been completed.

Allowance for doubtful accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We use a specific identification method for some items, and a percentage of aged receivables for others. The percentages are determined based on our past experience. If the financial condition of our customers were to deteriorate, our actual losses may exceed our estimates, and additional

Table of Contents

allowances would be required. At October 1, 2010 and October 2, 2009, our allowances for doubtful accounts were within management s expectations.

Derivatives

We account for derivatives in accordance with guidance on derivatives and hedging. As of October 1, 2010, derivatives consisted of our warrant to purchase 6.1 million shares of Mindspeed common stock. The fair value of this warrant is determined using a standard Black-Scholes-Merton valuation model with assumptions consistent with current market conditions and our intent to liquidate the warrant over a specified time period. The Black-Scholes-Merton valuation model requires the input of highly-subjective assumptions, including expected stock price volatility. Changes in these assumptions, or in the underlying valuation model, could cause the fair value of the Mindspeed warrant to vary significantly from period to period. There were no changes to the assumptions or underlying valuation model during the current fiscal year. Changes in the value of the warrant are recorded in income in the period in which they occur.

Inventories

We assess the recoverability of our inventories at least quarterly through a review of inventory levels in relation to foreseeable demand, generally over twelve months. Foreseeable demand is based upon all available information, including sales backlog and forecasts, product marketing plans and product life cycle information. When the inventory on hand exceeds the foreseeable demand, we write down the value of those inventories which, at the time of our review, we expect to be unable to sell. The amount of the inventory write-down is the excess of historical cost over estimated realizable value. Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand or product pricing is lower than originally projected, additional inventory write-downs may be required. Further, on a quarterly basis, we assess the net realizable value of our inventories. When the estimated average selling price of our inventory, net of selling expenses, falls below our inventory cost, we adjust our inventory to the current estimated market value.

Long-lived assets

Long-lived assets, including fixed assets and intangible assets (other than goodwill) are amortized over their estimated useful lives. They are also continually monitored and are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The determination of recoverability is based on an estimate of undiscounted cash flows expected to result from the use of an asset and its eventual disposition. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors. Estimates of undiscounted cash flows may differ from actual cash flows due to, among other things, technological changes, economic conditions, changes to our business model or changes in operating performance. If the sum of the undiscounted cash flows (excluding interest) is less than the carrying value, an impairment loss will be recognized, measured as the amount by which the carrying value exceeds the fair value of the asset. Fair value is determined using available market data, comparable asset quotes and/or discounted cash flow models. During fiscal year 2010, there were no triggering events or circumstances indicating an impairment of long-lived assets.

Goodwill

Goodwill is not amortized. Instead, goodwill is tested for impairment on an annual basis and between annual tests whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill is tested at the reporting unit level, which is defined as an operating segment or one level below the operating segment. Goodwill is tested annually during the fourth fiscal quarter and, if necessary, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill impairment testing is a two-step process.

The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. In our annual test in the fourth fiscal quarter of 2010, we assessed the fair value of our reporting unit for purposes of goodwill impairment testing based upon the fair value of the quoted market price of our common stock, which we believe is an accurate method of calculating fair value. The resulting fair value of the reporting unit is then compared to the carrying amounts of the net assets of the reporting unit, including goodwill. As we have only one reporting unit, the carrying amount of the reporting unit equals our net book value.

If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to that excess. Goodwill impairment testing requires significant judgment and management estimates, including, but not limited to, the determination of (i) the number of reporting units, (ii) the goodwill and other assets and liabilities to be allocated to the reporting units and (iii) the fair values of the reporting units. The estimates and assumptions described above, along with other factors such as discount rates, will significantly affect the outcome of the impairment tests and the amounts of any resulting impairment losses.

All of the goodwill reported on our balance sheet is attributable to our single reporting unit. During the fourth fiscal quarter of 2010, we determined, based on the methods described above, that the fair value of our single reporting unit is substantially in excess of the carrying value of our single reporting unit and therefore there is no impairment of goodwill as of October 1, 2010.

Income Taxes

We utilize the liability method of accounting for income taxes. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

In assessing the need for a valuation allowance, we consider all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Forming a conclusion that a valuation allowance is not required is difficult when there is negative evidence, such as cumulative losses in recent years. As a result of our cumulative losses in the U.S. and the full utilization of our loss carryback opportunities, management has concluded that a full valuation allowance against our net deferred tax assets is appropriate in such jurisdictions. In certain other foreign jurisdictions where we do not have cumulative losses, a valuation allowance is recorded to reduce the net deferred tax assets to the amount management believes is more likely than not to be realized. In the future, if we realize a deferred tax asset that currently carries a valuation allowance, a reduction to income tax expense may be recorded in the period of such realization.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position in accordance with the accounting guidance for uncertainty in income taxes. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. We recognize interest and penalties related to these unrecognized tax benefits in the income tax provision.

The accounting guidance also provides for derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures.

As a multinational corporation, we are subject to taxation in many jurisdictions, and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. If, based on new facts that arise in a period, management ultimately determines that the

Table of Contents

payment of these liabilities will be unnecessary, the liability will be reversed and we will recognize a tax benefit during the period in which it is determined the liability no longer applies. Conversely, we may record additional tax charges in a period in which it is determined that a recorded tax liability is less than the ultimate assessment is expected to be.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for federal, state or foreign taxes may be materially different from management s estimates, which could result in the need to record additional tax liabilities or potentially reverse previously recorded tax liabilities.

Valuation of equity securities

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

Stock-based compensation

We recognize the fair-value of stock-based compensation awards at the date of grant using the Black-Scholes option pricing model. In addition, forfeitures are estimated when recognizing compensation expense and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

The Black-Scholes-Merton model requires certain assumptions to determine an option fair value, including expected stock price volatility, risk-free interest rate, and expected life of the option. The expected stock price volatility rates are based on the historical volatility of our common stock. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option or award. The average expected life represents the weighted average period of time that options or awards granted are expected to be outstanding, as calculated using the simplified method. We measure service-based awards at the stock price on the grant date.

We have elected to adopt the alternative transition method for calculating the tax effects of stock-based compensation. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool, or APIC Pool, related to the tax effects of employee stock-based compensation expense, and to determine the subsequent impact on the APIC Pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that were outstanding at the adoption. In addition we have elected to recognize excess income tax benefits from stock option exercises in additional paid-in capital only if an incremental income tax benefit would be realized after considering all other tax attributes presently available to us, in accordance with applicable accounting guidance. See Note 9, to the consolidated financial statements for additional information.

Table of Contents

Restructuring charges

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

Results of Operations

Net Revenues

Net revenues consist of product sales, which we generally recognize upon shipment, less an estimate for returns and allowances. We sell our products to distributors, contract manufacturers (ODMs) and end-customers (OEMs), whose products include our products. End customers may purchase directly from us or from distributors or contract manufacturers.

Our net revenues increased 15% to $240.7 million in fiscal 2010 from $208.4 million in fiscal 2009. This increase was primarily driven by a 14% increase in unit volume shipments and a 1% increase in average selling prices (ASPs). The volume increase between fiscal 2010 and fiscal 2009 was driven by the shipment growth of our imaging, audio, and video solutions, partially offset by declines in our analog modems, specifically our computer modems and modems for digital television platforms in Japan. The increase in ASPs was attributable to a change in product mix, partially offset by pricing erosion in our audio and video businesses.

Our net revenues decreased 37% to $208.4 million in fiscal 2009 from $331.5 million in fiscal 2008. This decrease was primarily driven by a 21% decrease in ASPs and a 20% decrease in unit volume shipments. The revenue decline was primarily driven by the economic downturn combined with the modem business de-bundling trend and lower shipments of legacy wireless products.

We remain focused on capturing higher market share for our existing products and delivering new and innovative solutions for imaging, audio, and video applications. While we are enthusiastic about our current products and markets, we expect that declines in our analog modem and legacy wireless networking solutions will make it difficult to deliver overall revenue growth for the next several quarters.

Gross Margin

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

Our gross margin percentage for fiscal 2010 was 60.9% compared with 58.4% for fiscal 2009. The increase in gross margin percentage is attributable to lower product manufacturing costs and a favorable revenue product mix.

Our gross margin percentage for fiscal 2009 was 58.4% compared with 58.6% for fiscal 2008. Our gross margin percentage for fiscal 2008 includes a non-recurring royalty buyout of $14.7 million that occurred in the first quarter. The royalty buyout contributed 1.9% to our gross margin percentage during fiscal 2008. The increase in gross margin percentage is attributable to product cost reduction efforts and improved inventory management, resulting in lower excess and obsolete inventory provisions as a percentage of sales.

Research and Development

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

R&D expense increased $4.4 million, or 9%, in fiscal 2010 compared to fiscal 2009. The increase is due to higher compensation expenses from higher incentive programs and higher photo mask expenses.

R&D expense decreased $7.1 million, or 12%, in fiscal 2009 compared to fiscal 2008. The decrease is due to a 17% reduction in R&D headcount from September 2008 to September 2009, driven by restructuring activities and cost cutting measures, partially offset by our ongoing cost associated with our acquisition of the Freescale SigmaTel design center.

Selling, General and Administrative

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

SG&A expense decreased $14.5 million, or 23%, in fiscal 2010 compared to fiscal 2009. The decrease is primarily due to the 22% decline in SG&A headcount from fiscal 2009 to fiscal 2010, resulting from restructuring activities and cost-cutting measures.

SG&A expense decreased $15.2 million, or 19%, in fiscal 2009 compared to fiscal 2008. The decrease is primarily due to the 30% decline in SG&A headcount from September 2008 to September 2009 resulting from restructuring activities and cost-cutting measures.

Amortization of Intangible Assets

Amortization of intangible assets consists of amortization expense for intangible assets acquired in various business combinations. Our remaining intangible assets are being amortized over a weighted-average period of approximately 4.5 years.

Amortization expense decreased $1.8 million, or 58%, in fiscal 2010 compared to fiscal 2009. The decrease in amortization expense is primarily attributable to intangible assets that became fully amortized in fiscal 2009.

Amortization expense decreased $0.7 million, or 19%, in fiscal 2009 compared to fiscal 2008. The decrease in amortization expense is primarily attributable to the completion of amortization on an intangible asset in the third quarter of fiscal 2009.

Gain on Sale of Intellectual Property

In fiscal 2009, we sold a portfolio of patents including patents related to our wireless networking technology to a third party for cash of $14.5 million, net of costs, and recognized a gain of $12.9 million on the transaction. In accordance with the terms of the agreement with the third party, we retain a cross-license to this portfolio of patents.

Asset Impairments

During fiscal 2009, we recorded impairment charges of $10.8 million, consisting primarily of an $8.3 million impairment of a patent license with Freescale Semiconductor, Inc., land and fixed asset impairments of $1.4 million, electronic design automation (EDA) tool impairments of $0.8 million, intangible asset impairments of $0.3 million. Asset impairments recorded in continuing operations were $5.7 million, and asset impairments related to the BMP and BBA business units were $5.1 million and were recorded in discontinued operations.

Table of Contents

As a result of the sale of our BBA business and decrease in revenues in the continuing business, we determined that the technology license with Freescale Semiconductor Inc. had no value and therefore recorded an impairment charge of $8.3 million for the license, of which $3.3 million was recorded in discontinued operations and $5.0 million in operating expenses in the year ended October 2, 2009.

During fiscal 2008, we continued our review and assessment of the future prospects of our businesses, products and projects with particular attention given to the BBA business unit. The challenges in the competitive digital subscriber line (DSL) market resulted in the net book value of certain assets within the BBA business unit to be considered not fully recoverable. As a result, we recorded impairment charges of $108.8 million related to goodwill, $1.9 million related to intangible assets, $6.5 million related to property, plant and equipment and $3.4 million related to EDA tools. The impairment charges have been included in net loss from discontinued operations.

During fiscal 2008, we reevaluated our reporting unit operations with particular attention given to various scenarios for the BMP business. The determination was made that the net book value of certain assets within the BMP business unit were considered not fully recoverable. As a result, we recorded impairment charges of $119.6 million related to goodwill, $21.1 million related to EDA tools and technology licenses and $2.1 million related to property, plant and equipment, respectively. The impairment charges have been included in net loss from discontinued operations.

Asset impairment charged to continuing operations in fiscal 2008 of $0.3 million consisted primarily of property, plant and equipment charges.

Special Charges

	Fiscal Year Ended		
	2010	2009	2008
	(In thousands)		
Settlements	$ 589	$ 3,475	$
Other special charges	530		(112)
Restructuring charges	(282)	15,116	11,539
Voluntary Early Retirement Plan (VERP) settlement charge			6,294
Loss on disposal of property		392	961
	$ 837	$ 18,983	$ 18,682

Special charges for fiscal 2010 consisted primarily of an estimated settlement amount for unasserted insurance claims, lease charge and a one-time severance benefit associated with certain reductions in headcount, and credits due to an increase of subtenant income.

Special charges for fiscal 2009 consisted primarily of restructuring charges due to reduction of subtenant income from restructured office space and $3.5 million for a settlement of our class action lawsuit related to our 401(k) plan.

Special charges for fiscal 2008 consisted primarily of restructuring charges of $11.5 million that were primarily comprised of employee severance and termination benefit costs related to our fiscal 2008 restructuring actions. In addition, we incurred a charge of $6.3 million related to the settlement of our liability related to the VERP via the purchase of a non-participating annuity contract.

Interest Expense

Interest expense decreased $4.6 million, or 13%, during fiscal 2010 compared to fiscal 2009. The decrease is primarily attributable to lower debt balances due to the extinguishment of $238.8 million of our 4.00% convertible subordinated notes, partially offset by a higher interest rate charged on our 11.25% senior secured notes. Interest expense in fiscal 2010 and fiscal 2009 also includes debt discount amortization of $7.8 million and $14.0 million, respectively.

Table of Contents

Interest expense decreased $6.0 million, or 15%, during fiscal 2009 compared to fiscal 2008. The decrease is primarily attributable to lower debt balances due to our repurchase of $133.6 million of debt in 2008 and lower interest rates on our remaining variable rate debt.

Other (Income) Expense, Net

	Fiscal Year Ended		
	2010	2009	2008
	(In thousands)		
Investment and interest income	$ (265)	$ (1,747)	$ (7,237)
Gain on sale of investments	(16,054)	(1,856)	(896)
Loss on extinguishment of debt	18,583		
(Increase) decrease in the fair value of derivative instruments	(15,632)	(4,508)	14,974
Impairment of equity securities		2,770	
Loss on rental property			1,435
Loss on swap termination		1,087	
Other	913	(771)	947
Other (income) expense, net	$ (12,455)	$ (5,025)	$ 9,223

Other income of $12.5 million, net, during fiscal 2010 primarily consisted of a $16.1 million gain on sale of equity investments and a $15.6 million increase in the fair value of our warrant to purchase 6.1 million shares of Mindspeed common stock, partially offset by a loss of $18.6 million on extinguishment of debt, which consisted of $13.4 million of unamortized debt discount, $1.8 million premium over par paid upon extinguishment and $3.4 million of transaction costs.

Other income, net for fiscal 2009 was primarily comprised of a $4.5 million increase in the fair value of our warrant to purchase 6.1 million shares of Mindspeed common stock, $1.9 million in gains on sales of equity securities, $1.7 million of investment and interest income on invested cash balances, offset by $2.8 million of impairments on equity securities and a $1.1 million realized loss on the termination of interest rate swaps.

Other expense, net for fiscal 2008 was primarily comprised of $7.2 million of investment and interest income on invested cash balances, a $15.0 million decrease in the fair value of our warrant to purchase 6.1 million shares of Mindspeed common stock and $1.4 million of expense related to a rental property.

Provision for Income Taxes

In fiscal 2010, 2009 and 2008, we recorded income tax provisions of $0.6 million, $0.9 million and $0.8 million, respectively, primarily reflecting income taxes imposed on our foreign subsidiaries. All of our U.S. federal income taxes and the majority of our state income taxes are offset by fully reserved deferred tax assets. The Company has significant federal and state net operating losses and other deferred tax assets that the Company expects will eliminate its federal and the majority of its state taxes payable for the foreseeable future. When the Company believes that the future realization of its deferred tax assets is more likely than not, the Company will release some or all of its valuation allowance. If and when this occurs, the release of the valuation allowance will result in a deferred income tax benefit.

Gain (Loss) on Equity Method Investments

Gain (loss) on equity method investments includes our share of the earnings or losses of the investments that are recorded under the equity method of accounting, as well as the gains and losses recognized on the sale of our equity method investments.

Loss on equity method investments for fiscal 2010 and 2009 was $0.1 million and $2.8 million, respectively. Gain on equity method investments for fiscal 2008 was $2.8 million.

Table of Contents

Loss from Discontinued Operations, net of tax

Loss from discontinued operations, net of tax, consists of the operating results of our discontinued BMP and BBA businesses. For the fiscal years 2010, 2009 and 2008, BMP and BBA operations consisted of the following:

		Fiscal Year Ended	
	2010	**2009**	**2008**
		(In thousands)	
Net revenues	$ 1,428	$ 116,590	$ 351,179
Cost of goods sold	54	59,680	212,823
Gross margin	1,374	56,910	138,356
Operating expenses:			
Research and development	45	40,085	141,395
Selling, general and administrative	108	4,863	18,429
Amortization of intangible assets		4,430	12,492
Asset impairments		5,164	262,177
Special charges	2,157	14,518	2,791
Total operating expenses	2,310	69,060	437,284
Operating loss	(936)	(12,150)	(298,928)
Interest expense		2,741	12,836
Other expense (income), net	988	1,132	(9,682)
Loss from continuing operations before income taxes	(1,924)	(16,023)	(302,082)
Provision for income taxes	81	1,498	4,588
Loss from discontinued operations, net of tax	$ (2,005)	$ (17,521)	$ (306,670)

Liquidity and Capital Resources

Our principal sources of liquidity are our cash and cash equivalents, sales of non-core assets, borrowings and operating cash flow. In addition, we have generated additional liquidity in the past through the sale of equity securities.

Our cash and cash equivalents decreased $70.9 million between October 2, 2009 and October 1, 2010. The decrease was primarily due to the repurchase of our long-term and short-term debt, partially offset by common stock offerings and issuance of our 11.25% senior secured notes due 2015, restricted cash released upon repayment of our short-term debt and escrow, partially offset by the net purchase of marketable securities and cash generated by operations.

Cash flows are as follows (in thousands):

		Fiscal Year Ended	
	2010	**2009**	**2008**

	(In thousands)		
Net cash provided by (used in) operating activities	$ 4,478	$ 8,476	$ (18,350)
Net cash provided by investing activities	11,451	85,404	63,515
Net cash used in financing activities	(86,848)	(74,378)	(174,887)
Net increase (decrease) in cash and cash equivalents	$ (70,919)	$ 19,502	$ (129,722)

Operating Activities

Cash provided by operating activities was $4.5 million for fiscal 2010 compared to $8.5 million for fiscal 2009. Cash provided by operating activities for fiscal 2010 was primarily driven by $20.2 million in net income, net non-

Table of Contents

cash operating expenses of $6.2 million, partially offset by net cash used by changes in operating assets and liabilities of $22.0 million.

Cash provided by operating activities was $8.5 million for fiscal 2009 compared to $18.4 million used in operating activities in fiscal 2008. During fiscal 2009, we used $18.3 million of cash in operations and generated $26.8 million for working capital (accounts receivable, inventories, accounts payable and other accrued expenses). The changes in working capital were primarily driven by a $19.2 million decrease in accounts receivable and a $15.9 million decrease in inventories, offset by a $10.3 million decrease in accounts payable and a $2.0 million increase in other accrued expenses. The decreases in accounts receivable, inventories and accounts payable were primarily driven by the sale of the BBA business and overall lower business volume.

Investing Activities

Cash provided by investing activities was $11.5 million for fiscal 2010 compared to $85.4 million for fiscal 2009. Cash provided by investing activities for fiscal 2010 was primarily due to the release of restricted cash of $9.3 million, of which $8.5 million is associated with our repayment of short-term debt, and $6.8 million associated with divestiture contingency from the sale of our BBA business, partially offset by our net purchase of marketable securities of $3.4 million and capital expenditures of $2.0 million.

Cash provided by investing activities was $85.4 million for fiscal 2009 compared to $63.5 million for fiscal 2008. Cash provided by investing activities is primarily related to the $44.6 million in proceeds on the sale of the BBA business, $18.3 million in release of restricted cash, $14.5 million from sale of intellectual property and $10.4 million of proceeds from resolution of acquisition related escrow.

Financing Activities

Cash used in financing activities was $86.8 million for fiscal 2010 compared to $74.4 million for fiscal 2009. Cash used in financing activities for fiscal 2010, was primarily due to the extinguishment of our remaining floating rate senior secured notes due November 2010 for $62.0 million, extinguishment of our 4.00% convertible subordinated notes due March 2026 for $226.7 million and repayment of $29.1 million of our short-term debt, partially offset by the common stock offering and issuance of our 11.25% senior secured notes due 2015, net of expenses, of $62.5 million and $168.4 million, respectively and issuance of common stock under employee stock plans for $0.1 million.

Cash used in financing activities was $74.4 million for fiscal 2009 compared to $174.9 million for fiscal 2008. Cash used in financing activities is primarily comprised of our repurchase of our floating rate senior secured notes due November 2010 of $80 million and net repayments on our short-term debt of $12.4 million, offset by proceeds from a common stock offering of $18.4 million.

Recent Financing Transactions

In October 2009, we raised additional net proceeds of approximately $2.6 million from the exercise of the over-allotment option in connection with our September 2009 common stock offering of $18.4 million.

In December 2009, as further described below, our wholly-owned subsidiary, Conexant CF, LLC, established a $15.0 million credit facility with a bank. We are required to maintain certain minimum amounts on deposit (restricted cash) of approximately $0.8 million with the bank during the term of the credit agreement. As of October 1, 2010, no amounts had been borrowed under this facility.

In December 2009, we repurchased all outstanding floating rate senior secured notes due November 2010, amounting to $61.4 million, at a price of 101% of par. We also entered into exchange agreements with certain holders of our outstanding 4.00% convertible subordinated notes due March 2026 to issue an aggregate of 7.1 million shares of our common stock, par value $0.01 per share, in exchange for $17.6 million aggregate principal amount of the notes.

In March 2010, we sold 16.1 million shares of our common stock, including 2.1 million shares of common stock pursuant to an exercise by the underwriters of their over-allotment option, at a price of $4.00 per share, raising proceeds of approximately $59.9 million, net of expenses of $4.5 million. We also issued $175.0 million aggregate principal amount of 11.25% senior secured notes due 2015 at a price of 99.06%, raising proceeds of $168.4 million, net of expenses of $4.9 million. We also repurchased by means of a tender offer approximately $104.7 million of our 4.00% convertible subordinated notes due March 2026.

In May 2010, we repurchased by means of negotiated transactions approximately $116.5 million of our 4.00% convertible subordinated notes due March 2026.

At October 1, 2010, we had a total of $11.2 million aggregate principal amount of 4.00% convertible subordinated notes outstanding. These notes are due in March 2026, but the holders may require us to repurchase, for cash, all or part of their notes on March 1, 2011, March 1, 2016 and March 1, 2021 at a price equal to 100% of the principal amount, plus any accrued and unpaid interest. A further description of our 4.00% convertible subordinated notes is included in Note 7 of the consolidated financial statements. We were in compliance with all covenants under the indenture governing our 4.00% convertible subordinated notes as of October 1, 2010.

As of October 1, 2010, we also had a total of $175.0 million aggregate principal amount of 11.25% senior secured notes due 2015 outstanding. These notes accrue interest at a rate of 11.25% per annum payable semiannually on March 15 and September 15 of each year and mature on March 15, 2015. The obligations under the senior notes are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis, by all of our existing domestic subsidiaries (except for Conexant CF, LLC) and by all of our future domestic subsidiaries (except for immaterial subsidiaries and receivables financing subsidiaries). The notes and note guarantees are also secured by liens on substantially all of our and the guarantors tangible and intangible property, subject to certain exceptions and permitted liens. A further description of our 11.25% senior secured notes is included in Note 7 of the consolidated financial statements. We were in compliance with all covenants under the indenture governing our 11.25% senior secured notes as of October 1, 2010.

We are currently also committed to a plan for the sale of certain of our property located on Jamboree Road adjacent to our Newport Beach, California headquarters. The property consists of an approximately 25-acre site, including two leased buildings, certain personal property on the site, and all easements and other intangible rights appurtenant to the property.

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

Contractual Obligations and Commitments

Contractual obligations at October 1, 2010 were as follows (in thousands):

	Payments Due by Period					
	Total	Less Than 1 Year	1 Year	2 Years	3-5 Years	More Than 5 Years
Long-term debt	175,000	$	$	$	$ 175,000	$
Short-term debt	11,218	11,218				
Interest on debt	88,878	19,972	19,688	19,688	29,531	
Operating leases	81,344	14,582	12,672	12,703	30,585	10,802

Other purchase commitments	19,792	13,754	4,422	1,616		
	$ 376,232	$ 59,526	$ 36,782	$ 34,007	$ 235,116	$ 10,802

As discussed above, the holders of remaining $11.2 million of our 4.00% convertible subordinated notes due March 2026 could require us to repurchase all or part of their notes as early as March 1, 2011. As a result, the convertible subordinated notes are presented as being due in less than one year in the table above.

At October 1, 2010, we had many sublease arrangements on operating leases for terms ranging from near term to approximately seven years. Aggregate scheduled sublease income based on current terms is approximately $22.3 million and is not reflected in the table above.

Other purchase commitments include our commitments to foundries for wafer production, contractual obligations to acquire engineering design tools and other contractual payments.

In addition to the amounts shown in the table above, as of October 1, 2010, we have $68.0 million of unrecognized tax benefits, which includes $1.3 million for potential interest related to these unrecognized tax benefits. We are uncertain as to if or when such amounts may be settled.

Off-Balance Sheet Arrangements

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

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

We have other outstanding letters of credit collateralized by restricted cash aggregating $5.6 million to secure various long-term operating leases and our self-insured worker s compensation plan. The restricted cash associated with these letters of credit is classified as other long-term assets on the consolidated balance sheets.

Special Purpose Entities

We have one special purpose entity, Conexant CF, LLC (Conexant CF), which is our wholly-owned, consolidated subsidiary. Conexant CF is not permitted, nor may its assets be used, to guarantee or satisfy any of our obligations or those of our subsidiaries.

On November 29, 2005, we established an accounts receivable financing facility whereby we sold, from time to time, certain accounts receivable to a then-existing special purpose entity, Conexant USA, LLC (Conexant USA). Under the terms of our agreements with Conexant USA, we retained the responsibility to service and collect accounts receivable sold to Conexant USA and received a weekly fee from Conexant USA for handling administrative matters that equaled 1.0%, on a per annum basis, of the uncollected value of the accounts receivable. Our $50.0 million credit facility secured by the assets of Conexant USA expired on November 27, 2009. As permitted by the credit facility, all amounts owed on the credit facility were repaid as of January 1, 2010. Conexant USA was merged into Conexant Systems Worldwide, Inc. in the third fiscal quarter of 2010.

On December 22, 2009, we established a new accounts receivable financing facility whereby we sell, from time to time, certain accounts receivable to Conexant CF. Under the terms of our agreements with Conexant CF, we retain the responsibility to service and collect accounts receivable sold to Conexant CF and receive a weekly fee from Conexant CF for handling administrative matters that is equal to 1.0%, on a per annum basis, of the uncollected value of the purchased accounts receivable.

Concurrently with entering into the new accounts receivable financing facility, Conexant CF entered into a new credit facility to finance the cash portion of the purchase price of eligible receivables. The new credit facility is secured by the assets of Conexant CF. Conexant CF is required to maintain certain minimum amounts on deposit (restricted cash) of approximately $0.8 million with the bank during the term of the credit agreement. Borrowings under the credit facility, which cannot exceed the lesser of $15.0 million or 60% of the uncollected value of purchased accounts receivable that are eligible for coverage under an insurance policy for the receivables, bear interest equal to the bank prime rate (minimum of 3.25%) plus applicable margins (between 1.5% to 2.25%). As of October 1, 2010, eligible borrowings under this facility were $15.0 million. In addition, if the aggregate amount of interest earned by the bank in any month is less than $20,000, Conexant CF pays an amount equal to the minimum monthly interest of $20,000 minus the aggregate amount of all interest earned by the bank. The credit agreement matures on December 31, 2010 and remains subject to additional 364-day renewal periods at the discretion of the bank.

The credit facility is subject to financial covenants including a minimum level of shareholders equity covenant, an adjusted quick ratio covenant and a minimum cash and cash equivalents covenant. Further, any failure by us or Conexant CF to pay their respective debts as they become due would allow the bank to terminate the credit agreement and cause all borrowings under the credit facility to immediately become due and payable. At October 1, 2010, Conexant CF had not borrowed any amounts under this credit facility and was in compliance with all covenants under the credit facility.

Recently Adopted Accounting Pronouncements

On October 3, 2009, we adopted accounting guidance for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement), which requires the issuer to separately account for the liability and equity components of convertible debt instruments in a manner that reflects the issuer s hypothetical nonconvertible debt borrowing rate. The guidance resulted in recognizing a higher interest expense in our statement of operations due to amortization of the discount that results from separating the liability and equity components. The provisions of the accounting guidance were retrospectively applied, and all prior period amounts have been adjusted to apply the new method of accounting. Our Form 8-K filed on February 8, 2010 gave effect to the retrospective application of this accounting standard.

Recently Issued Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued revised guidance for the accounting of transfers of financial assets. This guidance improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. This accounting guidance will be effective for financial statements issued for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. Early adoption is not permitted. We do not believe that adoption of this guidance will have a material impact on our financial position and results of operations.

In June 2009, the FASB issued revised guidance for the accounting of variable interest entities, which replaces the quantitative-based risks and rewards approach with a qualitative approach that focuses on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance. This accounting guidance also requires an ongoing reassessment of whether an entity is the primary beneficiary and requires additional disclosures about an enterprise s involvement in variable interest entities. This accounting guidance will be effective for financial statements issued for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. Early adoption is not permitted. We do not believe that adoption of this guidance will have a material impact on our financial position and results of operations.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

Our financial instruments include cash and cash equivalents, short-term investments, a warrant to purchase Mindspeed common stock, short-term debt and long-term debt. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Consequently, we invest with only high credit quality issuers, and we limit the amount of our credit exposure to any one issuer.

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of October 1, 2010, the carrying value of our cash and cash equivalents approximated fair value.

We hold a warrant to purchase approximately 6.1 million shares of Mindspeed common stock at an exercise price of $16.74 per share through June 2013. For financial accounting purposes, this is a derivative instrument and

Table of Contents

the fair value of the warrant is subject to significant risk related to changes in the market price of Mindspeed s common stock. As of October 1, 2010, a 10% decrease in the market price of Mindspeed s common stock would result in a $3.0 million decrease in the fair value of this warrant. At October 1, 2010, the market price of Mindspeed s common stock was $7.73 per share. During fiscal 2010, the market price of Mindspeed s common stock ranged from a low of $2.98 per share to a high of $11.13 per share.

Our short-term debt consists of 4% convertible subordinated notes with interest at fixed rates. The fair value of our 4.00% convertible subordinated notes due March 2026 could be subject to significant fluctuation due to their convertibility into shares of our common stock and was calculated using a quoted market price in an active market.

Our long-term debt consists of 11.25% senior secured notes with interest at fixed rates. The fair value of the 11.25% senior secured notes is based on an indicative bid price provided by the underwriter of the senior secured notes.

The following table shows the fair values of our financial instruments as of October 1, 2010 (in thousands):

	Carrying Value	Fair Value
Cash and cash equivalents	$ 54,466	$ 54,466
Marketable securities	20,059	20,059
Mindspeed warrant	20,685	20,685
Long-term restricted cash	5,600	5,600
Short-term debt: convertible subordinated notes	11,218	11,232
Long-term debt: senior secured notes	175,000	168,000

Exchange Rate Risk

We consider our direct exposure to foreign exchange rate fluctuations to be minimal. Currently, sales to customers and arrangements with third-party manufacturers provide for pricing and payment in U.S. dollars, and, therefore, are not subject to exchange rate fluctuations. Increases in the value of the U.S. dollar relative to other currencies could make our products more expensive, which could negatively impact our ability to compete. Conversely, decreases in the value of the U.S. dollar relative to other currencies could result in our suppliers raising their prices to continue doing business with us. Fluctuations in currency exchange rates could affect our business in the future. At October 1, 2010, we did not have any foreign currency exchange contracts outstanding.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	October 1, 2010	October 2, 2009
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,466	$ 125,385
Marketable securities	20,059	
Restricted cash		8,500
Receivables, net of allowances of $368 and $453 at October 1, 2010 and October 2, 2009, respectively	31,463	30,110
Inventories, net	8,747	9,216
Other current assets	14,690	26,148
Assets held for sale	13,059	
Total current assets	142,484	199,359
Property, plant and equipment, net of accumulated depreciation of $30,050 and $70,139 at October 1, 2010 and October 2, 2009, respectively	6,080	15,299
Goodwill	109,908	109,908
Other assets	47,372	25,635
Total assets	$ 305,844	$ 350,201
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt	$	$ 61,400
Short-term debt	10,978	28,653
Accounts payable	12,516	24,553
Accrued compensation and benefits	7,682	8,728
Other current liabilities	31,836	33,978
Total current liabilities	63,012	157,312
Long-term debt	173,543	228,578
Other liabilities	57,197	62,089
Total liabilities	293,752	447,979
Commitments and contingencies (Note 6)		
Shareholders equity (deficit):		
Preferred and junior preferred stock: 20,000 and 5,000 shares authorized, respectively		

Common stock, $0.01 par value: 200,000 shares authorized; 81,273 and 56,917 shares issued and outstanding at October 1, 2010 and October 2, 2009, respectively	813	570
Additional paid-in capital	4,919,582	4,833,919
Accumulated deficit	(4,909,509)	(4,929,743)
Accumulated other comprehensive income (loss)	1,206	(2,524)
Total shareholders equity (deficit)	12,092	(97,778)
Total liabilities and shareholders equity	$ 305,844	$ 350,201

See accompanying notes to consolidated financial statements

41

Table of Contents

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Fiscal Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
	(In thousands, except per share amounts)		
Net revenues	$ 240,726	$ 208,427	$ 331,504
Cost of goods sold	94,157	86,674	137,251
Gross margin	146,569	121,753	194,253
Operating expenses:			
Research and development	55,745	51,351	58,439
Selling, general and administrative	48,249	62,740	77,905
Amortization of intangible assets	1,249	2,976	3,652
Gain on sale of intellectual property		(12,858)	
Asset impairments		5,672	277
Special charges	837	18,983	18,682
Total operating expenses	106,080	128,864	158,955
Operating income (loss)	40,489	(7,111)	35,298
Interest expense	30,072	34,693	40,713
Other (income) expense, net	(12,455)	(5,025)	9,223
Income (loss) from continuing operations before income taxes and (loss) gain on equity method investments	22,872	(36,779)	(14,638)
Provision for income taxes	567	871	849
Income (loss) from continuing operations before (loss) gain on equity method investments	22,305	(37,650)	(15,487)
(Loss) gain on equity method investments	(66)	(2,807)	2,804
Income (loss) from continuing operations	22,239	(40,457)	(12,683)
Gain on sale of discontinued operations, net of tax		39,170	6,268
Loss from discontinued operations, net of tax	(2,005)	(17,521)	(306,670)
Net income (loss)	$ 20,234	$ (18,808)	$ (313,085)
Income (loss) per share from continuing operations basic	$ 0.31	$ (0.81)	$ (0.26)
Income (loss) per share from continuing operations diluted	$ 0.30	$ (0.81)	$ (0.26)
Gain per share from sale of discontinued operations basic and diluted	$ 0.00	$ 0.78	$ 0.13

Loss per share from discontinued operations basic and diluted	$	(0.03)	$	(0.35)	$	(6.21)
Net income (loss) per share basic	$	0.28	$	(0.38)	$	(6.34)
Net income (loss) per share diluted	$	0.27	$	(0.38)	$	(6.34)
Shares used in basic per-share computations		72,903		49,856		49,394
Shares used in diluted per-share computations		73,708		49,856		49,394

See accompanying notes to consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
	(In thousands)		
Cash flows from operating activities			
Net income (loss)	$ 20,234	$ (18,808)	$ (313,085)
Adjustments to reconcile net loss to net cash used in operating activities, net of effects of acquisitions:			
Depreciation	3,409	8,198	19,311
Gain on sale of business		(39,170)	(6,268)
Amortization of intangible assets	1,249	7,406	16,144
Reversal of provision for bad debts, net	(85)	(325)	(751)
Charges for (reversal of) inventory provisions, net	80	(806)	7,253
Amortization of debt discount	8,008	14,015	13,394
Asset impairments		10,835	263,535
Other-than-temporary impairment of marketable and non-marketable securities		2,770	
Loss on termination of defined benefit plan			6,294
Deferred income taxes	(1,981)	(15)	(39)
Stock-based compensation	6,649	5,720	15,869
(Increase) decrease in fair value of derivative instruments	(15,632)	(4,002)	14,881
Loss on termination of swap	1,728	1,087	
Loss on extinguishment of debt	18,583		
Losses (gains) on equity method investments	172	3,798	(2,804)
Loss on resolution of pre-acquisition contingency		1,575	
Gain on sales of equity securities, investments and other assets	(16,054)	(1,856)	(896)
Gain on sale of intellectual property		(12,858)	
Currency translation adjustment recognized in net income	1,304		
Other items, net	(1,221)	4,149	4,021
Changes in assets and liabilities:			
Receivables	(1,268)	19,212	32,633
Inventories	389	15,871	9,326
Accounts payable	(12,122)	(10,341)	(45,010)
Accrued expenses and other current liabilities	(4,531)	(17,080)	(36,210)
Other, net	(4,433)	19,101	(15,948)
Net cash provided by (used in) operating activities	4,478	8,476	(18,350)
Cash flows from investing activities			
Purchases of property, plant and equipment	(2,041)	(686)	(5,958)
Proceeds from sales of property, plant and equipment	741	134	8,949
Proceeds from resolution of divestiture/acquisition contingencies	6,750	10,446	

Payments for acquisitions, net of cash acquired	(625)	(4,207)	(16,088)
Proceeds from sales of marketable securities	91,889	2,310	
Purchases of marketable securities	(95,334)		
Proceeds from sale of intellectual property		14,548	
Purchases of equity securities			(755)
Restricted cash	9,323	18,300	(18,000)
Net proceeds from sale of business		44,559	95,367
Return of capital from equity method investments	748		
Net cash provided by investing activities	11,451	85,404	63,515
Cash flows from financing activities			
Repayment of short-term debt	(29,136)	(12,365)	(39,883)
Extinguishment of debt	(288,748)	(80,000)	(133,600)
Proceeds from common stock offerings, net of offering costs of $4,881 and $1,514	62,510	18,436	
Proceeds from issuance of senior secured notes, net of offering costs of $4,920	168,440		
Proceeds from issuance of common stock under employee stock plans	124	28	1,088
Employee income tax paid related to vesting of restricted stock units	(38)	(258)	
Interest rate swap security deposit		2,517	(2,517)
Payment for swap termination		(2,815)	
Repayment of shareholder notes receivable		79	25
Net cash used in financing activities	(86,848)	(74,378)	(174,887)
Net (decrease) increase in cash and cash equivalents	(70,919)	19,502	(129,722)
Cash and cash equivalents at beginning of year	125,385	105,883	235,605
Cash and cash equivalents at end of year	$ 54,466	$ 125,385	$ 105,883

See accompanying notes to consolidated financial statements

Table of Contents

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIT) AND COMPREHENSIVE INCOME (LOSS)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss) (Net of Tax)	Notes Receivable from Stock Sales	Total Shareholders Equity (Deficit)
				(In thousands)			
Balance at September 28, 2007	49,236	$ 493	$ 4,791,774	$ (4,597,037)	$ (1,385)	$ (103)	$ 193,742
Net loss				(313,085)			(313,085)
Currency translation adjustment					(1,686)		(1,686)
Change in unrealized gain on derivative contracts					(837)		(837)
Change in unrealized losses on available-for-sale securities					(1,934)		(1,934)
Minimum pension liability adjustment					3,759		3,759
Comprehensive loss							(313,783)
Issuance of common stock	365	3	1,084				1,087
Reclassification to equity award			1,458				1,458
Adoption of FIN 48				(813)			(813)
Settlement of notes receivable						24	24
Employee stock-based compensation expense			15,869				15,869
Balance at October 3, 2008	49,601	496	4,810,185	(4,910,935)	(2,083)	(79)	(102,416)
Net loss				(18,808)			(18,808)
Currency translation adjustment					(1,104)		(1,104)
Change in unrealized gain on derivative					(3,017)		(3,017)

contracts							
Loss on termination of derivative contracts					1,746		1,746
Change in unrealized losses on available-for-sale securities					650		650
Other than temporary loss on available-for-sale securities					1,986		1,986
Sale of available-for-sale securities					(702)		(702)
Comprehensive loss							(19,249)
Common stock issued in offering	7,000	70	18,366				18,436
Common stock issued related to employee stock plans	316	4	(234)				(230)
Settlement of notes receivable						79	79
Employee stock-based compensation expense			5,602				5,602
Balance at October 2, 2009	56,917	570	4,833,919	(4,929,743)	(2,524)		(97,778)
Net income				20,234			20,234
Currency translation adjustment					685		685
Currency translation adjustment recognized in net income					1,304		1,304
Loss on termination of derivative contracts					1,728		1,728
Change in unrealized gain (loss) on available-for-sale securities					9,733		9,733
Sale of available-for-sale securities					(9,720)		(9,720)
Comprehensive income							23,964
Common stock issued in offering	17,150	171	62,339				62,510
Common stock issued in exchange for debt	7,063	71	16,590				16,661
Common stock issued related to employee stock plans	143	1	123				124
			6,611				6,611

Employee stock-based compensation expense													
Balance at October 1, 2010	81,273	$	813	$	4,919,582	$	(4,909,509)	$	1,206	$		$	12,092

See accompanying notes to consolidated financial statements

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 imaging, audio, embedded-modem, and video applications. These solutions include a comprehensive portfolio of imaging solutions for multifunction printers (MFPs), fax platforms, and interactive display frame market segments. The Company s audio solutions include high-definition (HD) audio integrated circuits, HD audio codecs, and speakers-on-a-chip solutions for personal computers, PC peripheral sound systems, audio subsystems, speakers, notebook docking stations, voice-over-IP speakerphones, USB headsets supporting Microsoft Office Communicator and Skype, and audio-enabled surveillance applications. The Company also offers a full suite of embedded-modem solutions for set-top boxes, point-of-sale systems, home automation and security systems, and desktop and notebook PCs. Additional products include decoders and media bridges for video surveillance security and monitoring applications, and system solutions for analog video-based multimedia applications.

Basis of Presentation The consolidated financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, include the accounts of the Company and each of its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Year The Company s fiscal year is the 52- or 53-week period ending on the Friday closest to September 30. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal year 2010 and 2009 were 52-week years and ended on October 1, 2010 and October 2, 2009, respectively. Fiscal year 2008 was a 53-week year and ended on October 3, 2008.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Among the significant estimates affecting the consolidated financial statements are those related to revenue recognition, allowance for doubtful accounts, inventories, long-lived assets (including goodwill and intangible assets), deferred income taxes, valuation of warrants, valuation of equity securities, stock-based compensation, restructuring charges and litigation. On an on-going basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

Revenue Recognition The Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the sales price and terms are fixed and determinable, and (iv) the collection of the receivable is reasonably assured. These terms are typically met upon shipment of product to the customer. The majority of the Company s distributors have limited stock rotation rights, which allow them to rotate up to 10% of product in their inventory two times per year. The Company recognizes revenue to these distributors upon shipment of product to the distributor, as the stock rotation rights are limited and the Company believes that it has the ability to reasonably estimate and establish allowances for expected product returns in accordance with accounting guidance for revenue recognition when right of return exists. Development revenue is recognized when services are performed and was not significant for any periods presented.

Revenue with respect to sales to customers to whom the Company has significant obligations after delivery is deferred until all significant obligations have been completed. At October 1, 2010 and October 2, 2009, deferred revenue related to shipments of products for which the Company has on-going performance obligations was none and $0.1 million, respectively. Deferred revenue is included in other current liabilities on the accompanying consolidated balance sheets.

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

Shipping and Handling In accordance with the accounting guidance for shipping and handling fees and costs, the Company includes shipping and handling fees billed to customers in net revenues. Amounts incurred by the Company for freight are included in cost of goods sold.

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

Marketable Securities The Company defines marketable securities as income yielding debt securities that can be readily converted into cash and equity securities acquired through strategic non-marketable investments that subsequently became listed on public markets. All of the Company s marketable debt securities are U.S. Treasury obligations rated Aaa or AAA by the major credit rating agencies.

The Company accounts for its investments in marketable securities as available-for-sale and determines the appropriate classification of such securities at the time of purchase and re-evaluates such classification as of each balance sheet date. Marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of shareholders equity (deficit), on the Company s consolidated balance sheets. Realized gains and losses were included in other expense (income), net in the accompanying consolidated statements of operations. Gains and losses on the sale of available-for-sale securities were determined using the specific-identification method. The Company did not hold any securities for speculative or trading purposes.

Restricted Cash The restricted cash balances consists of amounts pledged as collateral on outstanding letters of credit and minimum levels of cash deposits held by lending institution for a financing facility. The Company has letters of credit collateralized by restricted cash to secure various long-term operating leases and the Company s self-insured worker s compensation plan. The restricted cash associated with these letters of credit aggregating $5.6 million and $6.4 million is classified as other long-term assets on the consolidated balance sheets as of October 1, 2010 and October 2, 2009, respectively. The Company had also classified $8.5 million with respect to its short-term debt credit arrangement that expired on November 27, 2009 as short-term restricted cash as of October 2, 2009.

Inventories Inventories are stated at the lower of cost or market. Cost is computed using the average cost method on a currently adjusted standard basis (which approximates actual cost) and market is based upon estimated net realizable value. The valuation of inventories at the lower of cost or market requires the use of estimates as to the amounts of current inventories that will be sold and the estimated average selling price. These estimates are dependent on the Company s assessment of current and expected orders from its customers, and orders generally are subject to cancellation with limited advance notice prior to shipment.

Property, Plant and Equipment Property, plant and equipment are stated at cost. Depreciation is based on estimated useful lives (principally 10 to 27 years for buildings and improvements, 3 to 5 years for machinery and equipment, and the shorter of the remaining lease terms or the estimated useful lives of the improvements for land and leasehold improvements). Maintenance and repairs are charged to expense.

Investments The Company accounts for non-marketable investments using the equity method of accounting if the investment gives the Company the ability to exercise significant influence over, but not control of, an investee. Significant influence generally exists if the Company has an ownership interest representing between 20% and 50% of the voting stock of the investee. Under the equity method of accounting, investments are stated at initial cost and are adjusted for subsequent additional investments and the Company s proportionate share of earnings or losses and distributions. Additional investments by other parties in the investee will result in a reduction in the Company s ownership interest, and the resulting gain or loss will be recorded in the consolidated statements of operations. Where the Company is unable to exercise significant influence over the investee, investments are accounted for under the cost method, except for investments in limited partnerships, where the Company uses the equity method. Under the cost method, investments are carried at cost and adjusted only for other-than-temporary declines in fair value, distributions of earnings or additional investments.

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

Goodwill Goodwill is tested for impairment on an annual basis during the fourth fiscal quarter and between annual tests whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill is tested at the reporting unit level, which is defined as an operating segment or one level below the operating segment. Goodwill impairment testing is a two-step process.

The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. As the Company has only one reporting unit, the carrying amount of the reporting unit equals the net book value of the Company. In the Company s annual test in the fourth fiscal quarter of 2010, the Company assessed the fair value of its reporting unit based on the quoted market price of the Company s common stock as listed on the NASDAQ Global Select Market as of the date of the goodwill impairment analysis multiplied by shares outstanding also as of that date under the market approach. The resulting fair value of the reporting unit is then compared to the carrying amounts of the net assets of the reporting unit, including goodwill.

If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to that excess. Goodwill impairment testing requires significant judgment and management estimates, including, but not limited to, the determination of (i) the number of reporting units, (ii) the goodwill and other assets and liabilities to be allocated to the reporting units and (iii) the fair values of the reporting units. The estimates and assumptions described above, along with other factors such as discount rates, will significantly affect the outcome of the impairment tests and the amounts of any resulting impairment losses.

All of the goodwill reported on the Company s balance sheet is attributable to the Company s single reporting unit. During the fourth fiscal quarter of 2010, the Company determined, based on the method described above, that the fair value of the Company s single reporting unit is greater than the carrying value of the Company s single reporting unit and therefore there is no impairment of goodwill as of October 1, 2010.

Assets Held for Sale The Company evaluates an asset at the time an asset qualifies for held for sale criteria, to determine whether or not the carrying value exceeds its fair value less cost to sell. Any loss as a result of the carrying value being in excess of fair value less cost to sell is recorded in the period an asset meets the criteria. Management judgment is required to assess whether the criteria is met and estimate the expected net amount recoverable upon sale. As of October 1, 2010, the carrying values of the respective assets held for sale did not exceed their fair values less costs to sell.

Foreign Currency Translation and Remeasurement The Company s foreign operations are subject to exchange rate fluctuations and foreign currency transaction costs. The functional currency of all of the Company s foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign functional currencies are translated into U.S. dollars at the rates of exchange in effect at the balance sheet dates and income and expense items are translated at the average exchange rates prevailing during the period. Foreign currency translation adjustments are included in accumulated other comprehensive income (loss). The resulting foreign currency translation adjustments are charged to earnings in the period during which the investment in foreign subsidiaries is sold or liquidated. Gains and losses resulting from foreign currency transactions are recognized currently in earnings.

Table of Contents

At October 1, 2010, there were no foreign currency exchange contracts outstanding. The Company may use other derivatives from time to time to manage its exposure to changes in interest rates, equity prices or other risks. The Company does not enter into derivative financial instruments for speculative or trading purposes.

Net Income (loss) Per Share Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding and potentially dilutive securities outstanding during the period. Potentially dilutive securities include stock options and warrants and shares of stock issuable upon conversion of the Company s convertible subordinated notes. The dilutive effect of stock options and warrants is computed under the treasury stock method, and the dilutive effect of convertible subordinated notes is computed using the if-converted method. Potentially dilutive securities are excluded from the computations of diluted net loss per share if their effect would be antidilutive.

The following potentially dilutive securities have been excluded from the diluted net income (loss) per share calculations because their effect would have been antidilutive (in thousands):

	Fiscal Year Ended		
	2010	**2009**	**2008**
Stock awards	4,350	5,624	8,576
4.00% convertible subordinated notes due March 2026	228	5,081	5,081
	4,578	10,705	13,657

Stock-Based Compensation The Company measures compensation cost for all stock-based awards at fair value on the date of grant and recognize compensation expense in its consolidated statements of operations over the service period that the awards are expected to vest. The Company has elected to recognize compensation cost for all options with graded vesting on a straight-line basis over the vesting period of the entire option.

The Company uses the Black-Scholes-Merton model to value the compensation expense associated with stock options. In addition, forfeitures are estimated when recognizing compensation expense, and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods. The Company measures the fair value of service-based awards on the date of grant.

Income Taxes The provision for income taxes is determined in accordance with accounting guidance for income taxes. Deferred tax assets and liabilities are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities, applying enacted legislation and statutory tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded when it is more likely than not that some or all of the deferred tax assets will not be realized.

In assessing the need for a valuation allowance, the Company considers all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Forming a conclusion that a valuation allowance is not required is difficult when there is negative evidence, such as cumulative losses in recent years. As a result of the Company s cumulative losses in the

U.S. and the full utilization of the Company s loss carryback opportunities, management has concluded that a full valuation allowance against its net deferred tax assets is appropriate in such jurisdictions. In certain other foreign jurisdictions where the Company does not have cumulative losses, a valuation allowance is recorded to reduce the net deferred tax assets to the amount management believes is more likely than not to be realized. In the future, if the Company realizes a deferred tax asset that currently carries a valuation allowance, a reduction to income tax expense may be recorded in the period of such realization.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position in accordance with the accounting guidance for uncertainty in income taxes. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50%

likelihood of being realized upon ultimate settlement. The Company recognizes interest and penalties related to these unrecognized tax benefits in the income tax provision.

The accounting guidance also provides for derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures.

As a multinational corporation, the Company is subject to taxation in many jurisdictions, and the calculation of its tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. If, based on new facts that arise in a period, management ultimately determines that the payment of these liabilities will be unnecessary, the liability will be reversed and the Company will recognize a tax benefit during the period in which it is determined the liability no longer applies. Conversely, the Company records additional tax charges in a period in which it is determined that a recorded tax liability is less than the ultimate assessment is expected to be.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for federal, state or foreign taxes may be materially different from management s estimates, which could result in the need to record additional tax liabilities or potentially reverse previously recorded tax liabilities.

Concentrations Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, marketable securities, and trade accounts receivable. The Company invests its cash balances through high-credit quality financial institutions. The Company places its investments in investment-grade debt securities and limits its exposure to any one issuer. The Company s trade accounts receivable primarily are derived from sales to manufacturers of communications products, consumer products and personal computers and distributors. Management believes that credit risks on trade accounts receivable are moderated by the diversity of its products and end customers. The Company performs ongoing credit evaluations of its customers financial condition and requires collateral, such as letters of credit and bank guarantees, whenever deemed necessary.

At October 1, 2010, the Company had no customers owing more than 10% of the net accounts receivable balance. At October 2, 2009, there was one customer that accounted for 17% of the Company s accounts receivable. In fiscal 2010, 2009 and 2008, there was one distributor that accounted for 13%, 23%, and 23% of net revenues, respectively.

Supplemental Cash Flow Information Cash paid for interest was $17.4 million, $20.3 million and $34.0 million during fiscal 2010, 2009 and 2008, respectively. Net income taxes paid were $2.1 million, $1.4 million and $3.9 million during fiscal 2010, 2009 and 2008, respectively.

Accumulated Other Comprehensive Loss Other comprehensive loss includes foreign currency translation adjustments, unrealized gains (losses) on marketable securities, unrealized gains (losses) on foreign currency forward exchange contracts and unrealized gains (losses) on interest rate swaps. The components of accumulated other comprehensive loss are as follows (in thousands):

	October 1, 2010	October 2, 2009
Foreign currency translation adjustments	$ 1,193	$ (796)

Unrealized gains on marketable securities		13		
Unrealized losses on derivative instruments				(1,728)
Accumulated other comprehensive income (loss)	$	1,206	$	(2,524)

Business Enterprise Segments

The Company operates in one reportable segment semiconductor system solutions. Public business enterprises report information about operating segments in their annual consolidated financial statements. Following the sale of the Company s Broadband Access (BBA) operating segment, the results of which have been classified in discontinued operations, the Company has one remaining operating segment, comprised of one reporting unit, which was identified based upon the availability of discrete financial information and the chief operating decision makers regular review of the financial information for this operating segment.

Recently Adopted Accounting Pronouncements

On October 3, 2009, the Company adopted accounting guidance for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement), which requires the issuer to separately account for the liability and equity components of convertible debt instruments in a manner that reflects the issuer s hypothetical nonconvertible debt borrowing rate. The guidance resulted in the Company recognizing higher interest expense in the statement of operations due to amortization of the discount that results from separating the liability and equity components. The provisions of the accounting guidance were retrospectively applied, and all prior period amounts have been adjusted to apply the new method of accounting. The Company s Form 8-K filed on February 8, 2010 gave effect to the retrospective application of this accounting standard.

Recently Issued Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued revised guidance for the accounting of transfers of financial assets. This guidance improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. This accounting guidance will be effective for financial statements issued for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. Early adoption is not permitted. The Company does not believe that adoption of this guidance will have a material impact on its financial position and results of operations.

In June 2009, the FASB issued revised guidance for the accounting of variable interest entities, which replaces the quantitative-based risks and rewards approach with a qualitative approach that focuses on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance. This accounting guidance also requires an ongoing reassessment of whether an entity is the primary beneficiary and requires additional disclosures about an enterprise s involvement in variable interest entities. This accounting guidance will be effective for financial statements issued for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. Early adoption is not permitted. The Company does not believe that adoption of this guidance will have a material impact on its financial position and results of operations.

2. Sales of Assets

Fiscal 2010

Assets Held for Sale

In November 2009, the Company committed to a plan for the sale of certain of the Company s property located on Jamboree Road adjacent to its Newport Beach, California headquarters. The property consists of an approximately 25-acre site, including two leased buildings, certain personal property on the site, and all easements and other intangible rights appurtenant to the property. The Company determined that this property met the criteria for held for sale in accordance with the accounting guidance for impairment or disposal of long-lived assets. The

Table of Contents

Company has presented the cost of respective group of assets classified as held for sale separately on the consolidated balance sheet as of October 1, 2010 (in thousands):

	October 1, 2010
Land	$ 1,662
Land and leasehold improvements, net	307
Buildings, net	5,312
Machinery and equipment, net	268
Site development costs	5,510
	$ 13,059

The Company expects that the sale of these assets will be completed within the first half of fiscal 2011.

Fiscal 2009

In August 2009, the Company completed the sale of its BBA business to Ikanos Communications, Inc. (Ikanos). Assets sold pursuant to the agreement with Ikanos include, among other things, specified patents, inventory, contracts and tangible assets. Ikanos assumed certain liabilities, including obligations under transferred contracts and certain employee-related liabilities. The Company also granted to Ikanos a license to use certain of the Company s retained technology assets in connection with Ikanos s current and future products in certain fields of use, along with a patent license covering certain of the Company s retained patents to make, use, and sell such products (or, in some cases, components of such products).

At the closing of the transaction, the Company recorded aggregate proceeds of $52.8 million, which was comprised of $46.3 million in cash and $6.5 million of escrow funds, which represents the net present value of $6.8 million in escrowed funds deposited. Investment banking, legal and other fees related to the transaction amounted to $1.7 million. The escrow account was released in the fourth quarter of fiscal 2010. As a result of the completion of the transaction, certain assets and liabilities were applied to the net proceeds of $51.1 million received to calculate the net gain on the sale of $39.2 million.

In accordance with the accounting guidance for the impairment or disposal of long-lived assets, the Company determined that the BBA business, which constituted an operating segment of the Company, qualified as discontinued operations. The results of the BBA business have been reported as discontinued operations in the consolidated statements of operations for all periods presented. Interest expense has been allocated based on the provisions of the accounting guidance for allocation of interest to discontinued operations. For the fiscal years ended October 2, 2009 and October 3, 2008, interest expense allocated to discontinued operations was $2.7 million and $3.8 million, respectively. For fiscal year ended October 1, 2010, no interest expense was allocated to discontinued operations for BBA.

For the fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, BBA revenues and pretax (income) loss classified as discontinued operations was $1.4 million and $(1.0) million, $113.6 million and $4.8 million and $171.2 million and $130.0 million, respectively.

The Company has entered into a short-term transitional services agreement (TSA) with Ikanos which provides for ongoing logistical support by the Company to Ikanos, for which Ikanos will reimburse the Company. As of October 1, 2010 and October 2, 2009, the Company had a receivable under the TSA from Ikanos of approximately $0.3 million and $3.4 million, respectively, which is classified in other current assets. The Company also recorded approximately $0.7 million and $0.4 million in royalty revenue under the TSA agreement for the fiscal years ended October 1, 2010 and October 2, 2009, respectively.

Fiscal 2008

In August 2008, the Company completed the sale of its Broadband Media Processing (BMP) business to NXP B.V. (NXP). Pursuant to the asset purchase agreement with NXP, NXP acquired certain assets including, among other things, specified patents, inventory and contracts and assumed certain employee-related liabilities.

Pursuant to the agreement, the Company obtained a license to utilize technology that was sold to NXP and NXP obtained a license to utilize certain intellectual property that the Company retained. In addition, NXP agreed to provide employment to approximately 700 of the Company s employees at locations in the United States, Europe, Israel, Asia-Pacific and Japan.

At the closing of the transaction, the Company recorded proceeds of an aggregate of $110.4 million, which was comprised of $100.1 million in cash and $10.3 million of escrow funds, which represents the net present value of the $11.0 million in escrowed funds deposited. Investment banking, legal and other fees related to the transaction amounted to $3.6 million. As a result of the completion of the transaction, certain assets and liabilities, as well as $1.8 million of income tax on the gain on sale, were applied to the net proceeds of $106.8 million received to calculate the net gain on the sale of $6.3 million.

In accordance with the accounting guidance for the impairment or disposal of long-lived assets, the Company determined that the BMP business, which constituted an operating segment of the Company, qualified as discontinued operations. The results of the BMP business have been reported as discontinued operations in the consolidated statements of operations for all periods presented. Interest expense has been allocated based on the provisions of the accounting guidance for allocation of interest to discontinued operations. Interest expense reclassed to discontinued operations for fiscal years ended October 3, 2008 was $9.0 million. For fiscal year ended October 1, 2010 and October 2, 2009, no interest expenses were allocated to discontinued operations for BMP.

For the fiscal years ended October 1, 2010, October 2, 2009 and October 3, 2008, BMP revenues and pretax loss classified as discontinued operations were none and $2.9 million, $3.0 million and $11.2 million and $180.0 million and $172.1 million, respectively.

3. Business Combinations

Fiscal 2009

In December 2008, the Company acquired certain assets from Analog Devices Inc. (ADI) used in the operation of ADI s Integrated Audio Group (ADI Audio) and a license to the right to manufacture and sell certain products related to ADI Audio. Of the $3.8 million purchase price, $1.3 million was allocated to net tangible assets and $2.5 million was allocated to the cost of the license. As of October 2, 2009, the Company has paid $3.2 million in cash and recorded a payable of $0.6 million representing the final installment payment on the license, which was paid in fiscal 2010.

Fiscal 2008

In July 2008, the Company acquired Imaging Systems Group (ISG), Sigmatel Inc. s multi-function printer imaging products, for an aggregate purchase price of $16.1 million. Of the $16.1 million purchase price, $2.5 million was allocated to net tangible assets, $7.8 million was allocated to identifiable intangible assets, $5.0 million was allocated to goodwill and $0.8 million was expensed as in-process research and development in accordance with the accounting guidance for purchased research and development projects in a business combination. The identifiable intangible assets are being amortized on a straight-line basis over their weighted average estimated useful lives of approximately three years.

Both acquisitions were accounted for using the purchase method of accounting in accordance with the accounting guidance for business combinations. The Company s consolidated statements of operations include the results of ADI and ISG from the date of acquisition. The pro forma effect of the transactions was not material to the Company s consolidated statement of operations for the fiscal years ended October 2, 2009 and October 3, 2008.

Table of Contents

4. Fair Value of Certain Financial Assets and Liabilities

The following represents the Company s fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of October 1, 2010 (in thousands):

	Level 2
Assets:	
Marketable securities	$ 20,059
Mindspeed warrant	20,685
Total Assets	$ 40,744

Level 1 financial assets and liabilities consist of unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company had no financial assets or liabilities classified as Level 1 as of October 1, 2010 and October 2, 2009.

Level 2 financial assets and liabilities consist of the Company s marketable debt securities, whose values are based on broker or dealer quotes or the pricing of a similar security, and the Company s warrant to purchase approximately 6.1 million shares of Mindspeed common stock at an exercise price of $16.74 per share through June 2013. The Company had no marketable securities as of October 2, 2009. The fair value of the Mindspeed warrant was $5.1 million as of October 2, 2009.

Level 3 financial assets and liabilities consist of inputs that are both significant to the fair value measurement and unobservable. The Company had no financial assets or liabilities classified as Level 3 as of October 1, 2010 and October 2, 2009.

The fair value of other financial instruments, which consist of the Company s 4.00% convertible subordinated notes due March 2026 and the Company s 11.25% senior secured notes due 2015, was $11.2 million (for the 4.00% convertible subordinated notes) and $168.0 million (for the 11.25% senior secured notes) as of October 1, 2010. The fair value of the 4.00% convertible subordinated notes was calculated using a quoted market price in an active market. The fair value of the 11.25% senior secured notes is based on an indicative bid price provided by the underwriter of the senior secured notes.

The following table shows the gross unrealized gain and fair value for marketable securities as of October 1, 2010 (in thousands):

	Amortized Cost	Gross Unrealized Gain	Fair Value
October 1, 2010			
U.S. Treaury obligations	$ 20,046	$ 13	$ 20,059

5. Supplemental Balance Sheet Data

Inventories

Inventories consist of the following (in thousands):

	October 1, 2010	October 2, 2009
Work-in-process	$ 4,840	$ 5,002
Finished goods	3,907	4,214
Total inventories, net	$ 8,747	$ 9,216

The Company assesses the recoverability of inventories through an ongoing review of inventory levels in relation to sales backlog and forecasts, product marketing plans and product life cycles. When the inventory on hand exceeds the foreseeable demand, the value of inventory that at the time of the review is not expected to be sold is

&nbs