CONEXANT SYSTEMS INC
Form 8-K
November 22, 2002

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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 8-K

# CURRENT REPORT

**Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Date of Report (date of earliest event reported): November 22, 2002 (June 25, 2002)**

# CONEXANT SYSTEMS, INC.

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **000-24923** | **25-1799439** |
|---|---|---|
| (State of Incorporation) | (Commission File Number) | (I.R.S. Employer Identification No.) |

**4311 Jamboree Road**
**Newport Beach, California 92660-3095**
(Address of principal executive offices) (Zip code)

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

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**Explanatory Note:** This Current Report on Form 8-K provides, under the captions Selected Financial Data , Management s Discussion and Analysis of Financial Condition and Results of Operations , Quantitative and Qualitative Disclosures About Market Risk and Financial Statements and Supplementary Data , consolidated financial statements and other related financial information of Conexant Systems, Inc. (the Company) for the three years ended September 30, 2001, restated to present as discontinued operations the Company s wireless communications business and Mexicali operations, which were divested on June 25, 2002. This Current Report on Form 8-K should be read together with the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2001 and the Company s Quarterly Reports on Form 10-Q for the quarters ended December 31, 2001, March 31, 2002 and June 30, 2002.

**CAUTIONARY STATEMENT**

This Current Report on Form 8-K contains statements relating to future results of Conexant Systems, Inc. (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. Our actual results may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: the cyclical nature of the semiconductor industry and the markets addressed by our products and our customers products; demand for and market acceptance of new and existing products; successful development of new products; the timing of new product introductions; the successful integration of acquisitions; the availability of manufacturing capacity and raw materials; pricing pressures and other competitive factors; changes in our product mix; fluctuations in manufacturing yields; product obsolescence; our ability to develop and implement new technologies and to obtain protection of the related intellectual property; the successful implementation of our expense reduction and restructuring initiatives; the successful separation of our Broadband Communications and Mindspeed Technologies businesses; our ability to attract and retain qualified personnel; the safety and security of our employees and of our facilities; and the uncertainties of litigation, as well as other risks and uncertainties, including those set forth herein and those detailed from time to time in our filings with the Securities and Exchange Commission. These forward-looking statements are made only as of the date hereof, and we undertake no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

Mindspeed Technologies and AnyPort are trademarks of Conexant Systems, Inc. Other brands, names and trademarks contained in this report are the property of their respective owners.

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**Item 5. Other Events and Regulation FD Disclosure**

**Selected Financial Data**

The following selected financial data for the five years ended September 30, 2001 was derived from the consolidated financial statements of Conexant and subsidiaries and its predecessor Rockwell Semiconductor Systems, Inc., representing the semiconductor systems business of Rockwell International Corporation (Rockwell) and subsidiaries. In June 2002, Conexant completed the spin-off of its wireless communications business and the sale of its Mexicali operations. The selected financial data for all periods have been restated to reflect the wireless communications business and Mexicali operations as discontinued operations.

The financial data as of and for the years ended September 30, 2001, 2000 and 1999 are derived from the audited consolidated financial statements of Conexant. The financial data as of and for the years ended September 30, 1998 and 1997 are derived from the audited combined financial statements of Semiconductor Systems as part of Rockwell. The fiscal 1999 selected financial data include the operating results of Conexant while it was part of Rockwell prior to January 1, 1999. The financial data for periods prior to January 1, 1999 are not necessarily indicative of what the financial position or results of operations would have been had Conexant been an independent public company during those periods. 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.

| | 2001(1) | 2000(1) | 1999 | 1998 | 1997(1) |
|---|---|---|---|---|---|
| | (in thousands, except per share amounts) | | | | |
| **Statement of Operations Data** | | | | | |
| Net revenues | $ 847,056 | $1,790,616 | $1,268,099 | $1,121,165 | $1,363,124 |
| Cost of goods sold | 751,554 | 926,197 | 766,553 | 800,348 | 690,898 |
| Gross margin | 95,502 | 864,419 | 501,546 | 320,817 | 672,226 |
| Operating expenses: | | | | | |
| Research and development | 371,942 | 322,855 | 243,585 | 285,601 | 232,596 |
| Selling, general and administrative | 250,808 | 236,989 | 200,527 | 230,652 | 177,756 |
| Amortization of intangible assets | 324,805 | 154,679 | 8,364 | 11,020 | 9,178 |
| Special charges (2) | 389,616 | 35,000 | 36,474 | 190,086 | |
| Purchased in-process research and development | | 191,348 | | | 29,900 |
| Total operating expenses | 1,337,171 | 940,871 | 488,950 | 717,359 | 449,430 |
| Operating income (loss) | (1,241,669) | (76,452) | 12,596 | (396,542) | 222,796 |
| Debt conversion costs | (42,584) | | | | |
| Other income, net | 389 | 6,329 | 5,989 | 8,271 | 10,893 |
| Income (loss) before income taxes | (1,283,864) | (70,123) | 18,585 | (388,271) | 233,689 |
| Provision (benefit) for income taxes | (106,310) | 63,036 | 5,575 | (151,682) | 70,119 |
| Income (loss) from continuing operations | (1,177,554) | (133,159) | 13,010 | (236,589) | 163,570 |
| Loss from discontinued operations (3) | (275,064) | (57,768) | (81) | (25,627) | (37,746) |
| | (1,452,618) | (190,927) | 12,929 | (262,216) | 125,824 |

| | | | | | |
|---|---|---|---|---|---|
| Income (loss) before extraordinary item | | | | | |
| Extraordinary gain (4) | 7,284 | | | | |
| Net income (loss) | $(1,445,334) | $ (190,927) | $ 12,929 | $ (262,216) | $ 125,824 |
| Income (loss) from continuing operations per share (5): | | | | | |
| Basic | $ (4.81) | $ (0.63) | $ 0.07 | $ (1.20) | $ 0.77 |
| Diluted | (4.81) | (0.63) | 0.06 | (1.20) | 0.77 |
| **Balance Sheet Data** | | | | | |
| Working capital | $ 442,354 | $1,319,134 | $ 604,453 | $ 256,689 | $ 221,747 |
| Total assets | 2,815,480 | 4,416,197 | 1,841,950 | 1,418,530 | 1,485,759 |
| Long-term obligations | 709,849 | 999,997 | 350,000 | | |
| Shareholders equity | 1,773,176 | 2,906,759 | 1,035,153 | 1,009,375 | 1,106,558 |

(1) In fiscal 2001, we acquired HyperXS Communications, Inc. In fiscal 2000, we completed nine acquisitions in our continuing operations, including Microcosm Communications Limited in January; Maker Communications, Inc. in March; HotRail, Inc. in June; and Novanet Semiconductor Ltd. and NetPlane Systems, Inc. in September.

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In fiscal 1997, we acquired the Hi-Media broadband communication chipset business of ComStream Corporation. As a result of these acquisitions, during fiscal 2001 and 2000 we recorded $324.8 million and $154.7 million, respectively, in amortization of goodwill and other acquisition-related intangible assets and in fiscal 2000 and 1997 we recorded charges of $191.3 million and $29.9 million, respectively, related to purchased in-process research and development.

(2) In fiscal 2001, we recorded special charges of $389.6 million, principally related to the impairment of certain manufacturing assets and restructuring activities. In fiscal 2000, we recorded special charges of $35.0 million related to the settlement of certain litigation. In fiscal 1998, we recorded special charges of $147.1 million related to restructuring actions and $43.0 million related to litigation. In fiscal 1999, we recorded additional special charges of $36.5 million related to the restructuring actions we initiated in fiscal 1998.

(3) Loss from discontinued operations (net of income taxes) for all periods represents the operating results of our former wireless communications business and our Mexicali operations which we disposed of in June 2002.

(4) In fiscal 2001, we recorded an extraordinary gain on the extinguishment of debt, net of income taxes of $4.4 million.

(5) Income (loss) from continuing operations per share for all periods reflects our October 1999 2-for-1 stock split. Because we were not an independent company during all of fiscal years 1997-1999, income (loss) per share amounts for those years are calculated as if our spin-off from Rockwell had occurred on October 1, 1996.

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**Management s Discussion and Analysis of Financial Condition and Results of Operations**

**Overview**

We design, develop and sell semiconductor system solutions for communications applications. Our expertise in mixed-signal processing allows us to deliver integrated systems and semiconductor products which facilitate communications worldwide through wireline voice and data communications networks and emerging cable, satellite and fixed wireless broadband communications networks. We operate in two business segments: our Broadband Communications business and Mindspeed Technologies , our Internet infrastructure business.

Except where otherwise noted, this discussion of our financial condition and results of operations represents our continuing operations, excluding our discontinued wireless communications business and Mexicali operations.

Our Broadband Communications business designs, develops and sells semiconductor system solutions that connect personal access products such as set-top boxes, residential gateways, personal computers (PCs) and game consoles to voice, video and data processing services over broadband connections including asynchronous digital subscriber line (ADSL), cable and direct broadcast satellite. The Broadband Communications business also includes our foundation analog dial-up access portfolio, including PC data and fax modems, and our broadcast video encoder and decoder product family.

Mindspeed Technologies designs, develops and sells semiconductor networking solutions that facilitate the aggregation, processing, transmission and switching of data, video and voice primarily from the edge of the Internet to linked metropolitan area networks. Mindspeed Technologies products, ranging from physical-layer devices to higher layer network processors, are sold to infrastructure original equipment manufacturers (OEMs) and can be classified into two general categories: multi-service access products and broadband networking products. Our multi-service access products include a family of voiceband processor solutions designed to support voice and data services across wireline and wireless networks and are found in a variety of network access platforms such as remote access concentrators, media gateways and wireless base stations. Our broadband networking products include T/E carrier physical and link-layer products, multi-megabit digital subscriber line (DSL) transceivers, high-speed serializers/deserializers, crosspoint switches, lower-speed synchronous optical networking (SONET) physical media dependent devices and asynchronous transfer mode (ATM), multi-protocol label switching (MPLS) and packet network processors. These solutions are used in a variety of network equipment, including high-speed routers, ATM switches, optical switches, add-drop multiplexers and dense wave division multiplexers.

We market and sell our semiconductor products and system solutions directly to leading OEMs of communication electronics products and third-party electronic manufacturing service providers, and indirectly through electronic components distributors. Sales to distributors accounted for approximately 33% of our fiscal 2001 net revenues. For fiscal 2001, one distributor accounted for 11% of our net revenues and no other customer accounted for 10% or more of our net revenues. Our top 20 customers accounted for 57% of our fiscal 2001 net revenues. Revenues derived from customers located in the Americas, Europe, Japan and the Asia-Pacific region were 37%, 13%, 8% and 42%, respectively, of our net revenues for fiscal 2001. We believe a substantial portion of the products we sell to OEMs and third-party manufacturing service providers in the Asia-Pacific region are ultimately shipped to end markets in the Americas and Europe.

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. Our operating results have been, and may continue to be, negatively affected by substantial quarterly and annual fluctuations and market downturns due to a number of factors, such as changes in demand for end-user equipment, the timing of the receipt, reduction or cancellation of significant customer orders, 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, availability and cost of products from our suppliers, new product and technology introductions by our competitors, changes in the mix of products we produce and sell, intellectual property disputes, the timing and extent of product development costs and general economic conditions. In the past, average selling prices of established products have generally declined over time and we expect this trend to continue in the future.

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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. During fiscal 2001 and 2000, we completed ten acquisitions in our continuing operations, for aggregate consideration of $1.8 billion, to accelerate development efforts and fill technology gaps in our product portfolio. We treated each of these acquisitions as a purchase for financial accounting purposes and our results of operations reflect the operations of these businesses after the dates of acquisition.

***Spin-off and Merger of Wireless Communications Business***

On June 25, 2002, we completed the distribution to Conexant shareholders (the Spin-off Transaction) of outstanding shares of our wholly-owned subsidiary Washington Sub, Inc. (Washington), to which we contributed our wireless communications business, other than certain assets and liabilities which we retained, pursuant to the Contribution and Distribution Agreement dated as of December 16, 2001, as amended, by and between us and Washington. Immediately thereafter, pursuant to the Agreement and Plan of Reorganization dated as of December 16, 2001, as amended as of April 12, 2002, by and among us, Washington and Alpha Industries, Inc. (Alpha), Washington merged with and into Alpha, with Alpha the surviving corporation (the Merger). As a result of the Spin-off Transaction and the Merger, Conexant shareholders received 0.351 of a share of Alpha common stock for each Conexant share held and continued to hold their Conexant shares.

Upon completion of the Merger, Alpha and its subsidiaries purchased our semiconductor assembly, module manufacturing and test facility located in Mexicali, Mexico and our package design team that supports the Mexicali facility. In connection with the purchase, we, Alpha and certain subsidiaries of Alpha entered into a financing agreement pursuant to which Alpha and a subsidiary of Alpha delivered to us promissory notes for $150 million (the Term Notes) guaranteed by Alpha and certain Alpha subsidiaries and secured by substantially all assets of Alpha in payment of the purchase price for the Mexicali facility and the package design team. The Term Notes, dated June 25, 2002, were to mature 50 percent in March 2003 and 50 percent in June 2003 and were to bear interest initially at 10 percent, increasing to 12 percent in three months and 15 percent in six months. The financing agreement also provided for a revolving credit facility under which Alpha could borrow up to $100 million, less specified reserves, for one year at the same interest rate and with the same security applicable to the Term Notes.

As of September 30, 2002, we held notes receivable from Alpha (now named Skyworks Solutions, Inc. (Skyworks)) with an aggregate principal amount of $180.0 million, including the $150.0 million Term Notes and $30.0 million outstanding under the revolving credit facility. In November 2002, we entered into a refinancing agreement with Skyworks pursuant to which Skyworks repaid $105.0 million of the principal amount and all of the accrued interest owed to us under the Term Notes and the remaining principal balance of the Term Notes was exchanged for $45.0 million principal amount of a new 15% convertible note with a maturity date of June 30, 2005. Skyworks also paid us all amounts outstanding under the credit facility, the credit facility was cancelled and we released all security interests in Skyworks' assets and properties. Skyworks may redeem the 15% convertible note at any time after May 12, 2004, subject to a redemption premium of 3% of the outstanding principal amount. We may, at our option, convert the outstanding principal amount of the 15% convertible note into shares of Skyworks common stock based upon the conversion price (initially $7.87 per share, subject to adjustment under certain circumstances). At maturity, Skyworks must pay the outstanding principal amount by delivering to us a number of shares of its common stock based upon the conversion price. We may also exchange the 15% convertible note for an equal aggregate principal amount of substantially similar 15% convertible senior subordinated notes to be issued under an indenture and Skyworks has granted us certain registration rights relating to the 15% convertible senior subordinated notes and the shares of Skyworks common stock underlying the 15% convertible note and the 15% convertible senior subordinated notes.

***Strategic Initiatives***

During fiscal 2001, we implemented a number of strategic initiatives to focus investment and resources in the areas that best support our strategic growth drivers the broadband communications and Internet infrastructure markets.

In the third quarter of fiscal 2001, we decided to realign our manufacturing and procurement strategies to accelerate our transition from volume digital complementary metal-oxide semiconductor (CMOS) manufacturing to a fabless CMOS business model. We have discontinued advanced CMOS process technology development efforts beyond 0.13 micron capability, as well as further investments in CMOS manufacturing capacity. We have entered into long-term supply agreements with major foundry partners to obtain additional external CMOS wafer fabrication capacity. We also sold our photomask operations to a major manufacturer of photomasks and entered into a long-term supply agreement with the buyer for access to advanced photomask process technologies and services.

As a result of our decision to realign our manufacturing and procurement strategies, combined with the then-current and projected business conditions, we recorded impairment charges during the third quarter of fiscal 2001 totaling $342.8 million to write down the carrying value of certain manufacturing assets in our Broadband Communications segment, including the assets of our Newport Beach, California wafer fabrication operations.

During fiscal 2001, we sold our global positioning system (GPS) business to SiRF Technology, Inc. (SiRF), a privately-held company focused on GPS applications, in exchange for shares of SiRF stock. As part of the agreement, our former wireless communications business received certain license rights to SiRF s GPS technology, and retained rights to certain GPS technology developed by us, for use in mobile communications applications. In

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addition, in fiscal 2002 we sold our board-level sub-assembly business and the related module assembly plant in El Paso, Texas.

***Expense Reduction and Restructuring Initiatives***

In fiscal 2001, we implemented a number of expense reduction and restructuring initiatives to more closely align our cost structure with the current business environment. The cost reduction initiatives include workforce reductions, temporary shutdowns of our manufacturing facilities, significant reductions in capital spending, the consolidation of certain facilities and salary reductions for our senior management team until we return to profitability.

During fiscal 2001, we reduced our workforce by approximately 1,200 employees (through involuntary severance programs and attrition), a 22% reduction from January 2001 levels. In addition to the workforce reductions, we periodically idled our wafer fabrication facility in Newport Beach, California.

During fiscal 2001, we recorded restructuring charges of $20.1 million related to the workforce reductions completed through September 30, 2001 and the consolidation of certain facilities. The fiscal 2001 restructuring initiatives and other expense reduction actions taken, when combined with the reduction in depreciation expense as a result of the write-down of the impaired manufacturing assets, resulted in a quarterly reduction of manufacturing and operating expenses of approximately $60 million for the fourth quarter of fiscal 2001 as compared with the second quarter of fiscal 2001.

***Separation of Broadband Communications and Mindspeed Technologies Businesses***

In March 2001, our Board of Directors approved in principle a revised plan for the separation of our Broadband Communications and Mindspeed Technologies businesses. Although current business conditions have delayed the separation, we remain committed to completing the separation as soon as business and market conditions permit. The separation is subject to receipt of a ruling from the Internal Revenue Service (IRS) that the related spin-off will qualify as a tax-free distribution and may be subject to the approval of our shareholders. An IRS ruling has been received and although it is generally binding on the IRS, its continuing validity will depend on the form of the separation transaction and the extent of intervening events between the date of the ruling and the separation. We cannot assure you that we will successfully complete the separation.

**Recent Developments**

***Results of Operations for the Fiscal Year Ended September 30, 2002***

On October 22, 2002, we announced our results of operations for the fiscal year ended September 30, 2002. Our net revenues for fiscal 2002 were $601.8 million compared to $847.1 million for fiscal 2001 due to sharply reduced end-customer demand in many of the communications electronics end-markets which our products address. We incurred a loss from continuing operations of $812.3 million ($3.14 per share) for fiscal 2002 compared to a loss from continuing operations of $1.2 billion ($4.81 per share) for fiscal 2001. Including our discontinued operations, we incurred a net loss of $880.8 million ($3.40 per share) for fiscal 2002 compared to a net loss of $1.4 billion ($5.91 per share) for fiscal 2001. Our loss from continuing operations for fiscal 2002 includes special charges of $199.4 million for asset impairments, restructuring charges and separation costs, compared to special charges of $389.6 million for asset impairments, restructuring charges and separation costs in fiscal 2001.

As of September 30, 2002, our cash and cash equivalents, marketable securities and notes receivable from Skyworks totaled $447.8 million compared to $338.9 million at September 30, 2001. Our working capital as of September 30, 2002 totaled $441.2 million compared to $442.4 million at September 30, 2001. The September 30, 2002 working capital balance includes the $180.0 million notes receivable from Skyworks.

***Newport Foundry Joint Venture***

In March 2002, we and The Carlyle Group formed a new specialty foundry company named Jazz Semiconductor, Inc. (Jazz). We contributed our Newport Beach, California wafer fabrication operations and related assets and liabilities and certain intellectual property to Jazz. We also issued to Jazz a warrant to purchase 2.9 million shares of Conexant common stock (at a price of $4.62 per share, as adjusted to reflect the Spin-off Transaction). In connection with this transaction, we received $19.3 million in cash and a 45% equity

interest in the joint venture, having an estimated fair value of $42.5 million. We recognized a $2.6 million gain on the transaction.

We expect to purchase a substantial portion of our requirements for silicon-based semiconductor products from Jazz. We entered into a long-term supply arrangement with Jazz under which it will provide capacity to meet a portion of our requirements for CMOS and specialty-process wafer fabrication services and we agreed to purchase certain minimum annual volumes of wafers during the first three years of the supply agreement. We expect the future minimum purchase obligation under the long-term supply agreement with Jazz, net of a portion of the wafer purchase obligations assumed by a third party, will be approximately $71 million, $43 million and $14 million in fiscal 2003, fiscal 2004 and fiscal 2005, respectively.

***Digital Imaging Divestiture***

In July 2002, we merged our digital imaging business with Zing Network, Inc., a developer of advanced connectivity and imaging software, to create a new privately held company named Pictos Technologies, Inc. (Pictos). In connection with this transaction, we contributed the assets and intellectual property of our digital imaging business to Pictos in exchange for shares of Pictos stock.

***Acquisition of Video Compression Business***

In June 2002, we acquired the video compression business of iCompression, Inc. (iCompression), a wholly-owned subsidiary of GlobespanVirata, Inc. The acquisition will enable us to accelerate the development of video products for the encoder markets including personal computers and cable set-top boxes. Consideration for the acquisition consisted of 1.25 million shares of our common stock and promissory notes for $21 million, a portion of which are initially held in escrow for the settlement of any contingent indemnity claims through the expiration of a one-year escrow period. We may be required to pay additional consideration of up to $20 million pursuant to an earn-out provision if certain revenue milestones are achieved. In addition, we guaranteed the value of the shares we issued to iCompression and we may be required to make additional cash payments to iCompression for the difference between $12.00 and the market value per share of the shares of common stock delivered to iCompression (including the market value of Skyworks common stock received in respect thereof). We paid the amounts owed under the promissory notes in July 2002.

***Expense Reduction and Restructuring Initiatives***

In June and July 2002, we announced a number of expense reduction and restructuring initiatives, principally in our Mindspeed Technologies business. These restructuring initiatives are intended to reduce our operating cost structure and to focus our research and development spending on products for the Internet infrastructure market segments our products address, such as the metro/access market segments, which we believe present the most attractive near-term growth prospects. Our key products for metro/access applications include our multi-service voice over packet, T/E carrier, and ATM/MPLS network processor solutions.

The restructuring initiatives include the elimination of research and development spending in high-end optical networking applications, the closure of our Novanet Semiconductor Limited (Novanet) design center in Israel, the planned divestiture of our NetPlane Systems, Inc. (NetPlane) subsidiary and a reduction of support services spending. These actions will reduce Mindspeed s workforce by over 400 employees (approximately 35% of Mindspeed s workforce). We expect to complete these actions by the end of calendar year 2002. As a result of these restructuring initiatives, we expect to record additional restructuring charges of approximately $60 million to $70 million through the first quarter of fiscal 2003.

***Asset Impairments***

Our restructuring initiatives in the Mindspeed Technologies segment are intended to focus our research and development spending on products for the Internet infrastructure market segments we believe offer the most attractive near-term growth prospects, such as our products for metro/access applications. We believe that end markets for optical long-haul networks offer weaker recovery prospects, with slow adoption of new, higher speed networks. We determined that this weak demand would adversely affect the potential return on continued investment in our Novanet business, which was engaged in the development of semiconductor products for high-speed synchronous optical networking (SONET) applications, and in June 2002 we closed the Novanet design center in Israel, which represented substantially all of Novanet s operations. We also expected this weak demand would adversely affect the operating performance of our NetPlane business and determined to divest the NetPlane business. NetPlane develops and sells networking protocol software and systems for control plane applications in networking equipment. We have held preliminary discussions with potential buyers for NetPlane and anticipate completing the divestiture of NetPlane in the first quarter of fiscal 2003.

As a result of these decisions, in the third quarter of fiscal 2002 we recorded impairment charges of $114.1 million to write down the carrying value of certain long-lived assets associated with these operations. Substantially all of the $61.0 million impairment charge for Novanet was

recorded to write down the carrying value of goodwill. The amount of the impairment charge was the excess of the carrying value of the goodwill over its fair value, which we estimated to be zero because we did not expect to realize any significant cash flows from Novanet. The $53.1 million impairment charge for NetPlane included the balances of goodwill ($40.8 million) and identified intangible assets ($12.3 million). The amount of the impairment charge was the excess of the carrying value over fair value, which we estimated to be zero because we did not expect to realize any significant cash flows from the disposition of NetPlane.

**Results of Operations**

During fiscal 2001, we like many of our customers and competitors were adversely impacted by a broad slowdown affecting the technology sector, including most of the communications electronics end-markets which our products address. Broadband Communications net revenues for fiscal 2001 were affected by slower than anticipated deployment of broadband services by system providers. Moreover, weak consumer demand for PCs and related

peripheral devices and satellite set-top boxes led to lower sales of our products for these applications. Net revenues in our Mindspeed Technologies business were affected by slowing investment in communications network capacity expansion by Internet service providers (ISPs), competitive local exchange carriers (CLECs) and incumbent local exchange and inter-exchange carriers. In most cases, the effect of weakened end-customer demand was compounded by higher than normal levels of equipment and component inventories among our OEM, subcontractor and distributor customers.

The overall slowdown in the communications electronics markets has also impacted our gross margins and operating income. Cost of goods sold for fiscal 2001 was adversely affected by the significant underutilization of our manufacturing capacity. Our cost of goods sold for fiscal 2001 reflects $188.8 million of inventory write-downs across our product portfolio resulting from the sharply reduced end-customer demand for set-top boxes, PC peripherals and Internet infrastructure equipment. During fiscal 2001, we also recorded $23.1 million of additional provisions for accounts receivable from slow-paying customers which we believed we would not be able to collect.

**Net Revenues**

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

The following table summarizes our net revenues by business segment:

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| ***Net revenues:*** | | | | | |
| Broadband Communications | $541.7 | (55)% | $1,211.4 | 22% | $ 990.5 |
| Mindspeed Technologies | 305.4 | (47)% | 579.2 | 109% | 277.6 |
| Total net revenues | $847.1 | (53)% | $1,790.6 | 41% | $1,268.1 |
| ***As a percentage of net revenues:*** | | | | | |
| Broadband Communications | 64% | | 68% | | 78% |
| Mindspeed Technologies | 36% | | 32% | | 22% |
| | 100% | | 100% | | 100% |

***Broadband Communications***

Broadband Communications net revenues for fiscal 2001 declined 55%, reflecting lower unit shipments of our dial-up modem solutions resulting from weak consumer demand for PCs and related peripheral devices, and the excess channel inventory throughout the PC OEM product pipeline. Revenues from our embedded modem solutions, which enable communications in a variety of personal communications devices such as gaming consoles, web browsers and handheld devices, also decreased due to weak consumer demand during fiscal 2001 and the decision of a major OEM customer to exit the gaming console market. Revenues for our media processing products, including video encoders and decoders, declined as a result of the overall weakness in demand for consumer PCs and reduced demand for legacy low-speed modems used in satellite set-top box applications. Net revenues from our strategic broadband communications portfolio, including cable modems and satellite set-top box tuners and demodulators, were similarly affected by lower consumer demand and high levels of component inventories at OEMs. The three acquisitions we completed in our Broadband Communications business in fiscal 2000 contributed $6.0 million of revenue for fiscal 2001 compared with $4.8 million for fiscal 2000.

Broadband Communications net revenues for fiscal 2000 grew 22% over fiscal 1999, reflecting strong growth in

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sales of our embedded modems. We also achieved strong demand through fiscal 2000 for our video processing solutions used in personal computing applications as well as increased shipments of tuners, demodulators, encoders, and back-channel telephony solutions, primarily for satellite set-top box applications. Fiscal 2000 results also included initial volume shipments of our cable modem products for European digital video broadcast and North American Data Over Cable Service Interface Specification (DOCSIS) applications, as well as the initial production shipments of our ADSL chipset solutions supporting delivery of broadband communication services for residential applications.

***Mindspeed Technologies***

Net revenues for Mindspeed Technologies for fiscal 2001 reflect the sharply lower demand for network equipment which has affected us, our customers and our competitors. ISPs and CLECs have dramatically reduced their investment in network capacity expansion as their business models fail to generate sufficient cash flow. Incumbent local exchange carriers and inter-exchange carriers have also reduced their capital spending. Demand has been further affected by higher-than-normal levels of equipment and component inventories among many OEM, subcontractor and distributor customers. As a result, in fiscal 2001 we experienced a steep decline in revenues from our AnyPort family of multi-service access processors and, to a lesser extent, our multi-megabit DSL, optical networking and network processor products. The six acquisitions we completed in our Mindspeed Technologies business in fiscal 2000 contributed $53.4 million of revenue for fiscal 2001 compared with $27.7 million for fiscal 2000.

In fiscal 2000, Mindspeed Technologies net revenues increased 109% from fiscal 1999 levels as demand for our networking semiconductor products and system solutions increased significantly due to the then-current need for network infrastructure OEMs to support the build-out and upgrade of both public and private communications networks. Demand increased for our optical networking, ATM, network processor and T/E carrier products, used in network infrastructure equipment for metropolitan and optical backbone networks. We also experienced greater demand for our high-speed DSL products, used by network infrastructure OEMs in DSL access multiplexers, integrated access devices and other products for the delivery of symmetric DSL (SDSL) services. We also saw increased demand from network infrastructure OEMs for our AnyPort family of multi-service access processors.

**Gross Margin**

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Gross margin | $95.5 | (89)% | $864.4 | 72% | $501.5 |
| Percent of net revenues | 11% | | 48% | | 40% |

Gross margin represents revenues less cost of goods sold. Our cost of goods sold consists predominantly of purchased materials, labor and overhead (including depreciation) associated with product manufacturing and procurement, royalty and other intellectual property costs and sustaining engineering expenses pertaining to products sold. Our gross margin for fiscal 2001 reflects the impact of lower sales volume on a base of relatively fixed manufacturing support costs. Gross margin for fiscal 2001 reflects inventory write-downs of $188.8 million, partially offset by the sale of $6.8 million of these written-down goods in the fiscal 2001 fourth quarter. Cost of goods sold also includes provisions for excess and obsolete inventories of $17.1 million, $4.6 million and $7.5 million for fiscal 2001, 2000 and 1999, respectively.

The gross margin improvement in fiscal 2000 compared with fiscal 1999 principally reflected a shift in our product mix toward higher-margin products. The gross margin improvement also reflected higher factory utilization at our wafer fabrication facilities that resulted from increased unit sales volume. Gross margins for fiscal 1999 were adversely affected by unusually high inventory costs which resulted from low manufacturing capacity utilization during the last four months of fiscal 1998.

The fiscal 2001 inventory write-downs resulted from the sharply reduced end-customer demand for PCs and Internet infrastructure equipment during that period. As a result of these market conditions, we experienced a significant number of order cancellations and a decline in the volume of new orders beginning in the fiscal 2001 first quarter and our first quarter revenues decreased 29% compared with the immediately preceding quarter. The reduced global demand for our products and system solutions became more pronounced in the second and third quarters of fiscal 2001, and we experienced further sequential decreases in our quarterly revenues of 40% and 23%, respectively, in those periods. As a result of our ongoing assessment of the recoverability of our inventories, we recorded inventory write-downs of $47.1 million, $102.9 million and $38.8 million in the first, second and third quarters, respectively, of

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fiscal 2001. The inventories written down in fiscal 2001 principally consisted of voiceband processors, multi-megabit DSL transceivers, satellite set-top box tuners and demodulators, ADSL modems and analog modems for non-PC applications.

We assess the recoverability of our inventories at least quarterly through a review of inventory levels in relation to foreseeable demand. Foreseeable demand is based upon all available information, including sales backlog and forecasts, product marketing plans and product life cycles. 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.

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

During fiscal 2001, we sold $6.8 million of inventories previously written down to a zero cost basis and scrapped $26.4 million of previously written-down inventories. The sales resulted from increased demand beginning in the fourth quarter of fiscal 2001 which was not anticipated at the time of the write-downs. The previously written-down inventories were generally sold at prices which exceeded their original cost.

As of September 30, 2001, we continued to hold inventories with an original cost of approximately $155.6 million which were previously written down to a zero cost basis. We currently intend to hold these remaining inventories and will sell these inventories if we experience renewed demand for these products. While there can be no assurance that we will be able to do so, if we are able to sell a portion of the inventories which are carried at zero cost basis, our gross margins will be favorably affected. To the extent that we do not experience renewed demand for the remaining inventories, they will be scrapped as they become obsolete.

We base our assessment of the recoverability of our inventories, and the amounts of any write-downs, on currently available information and assumptions about future demand (generally over six months) and market conditions. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand is lower than originally projected, additional inventory write-downs may be required.

**Research and Development**

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Research and development | $371.9 | 15% | $322.9 | 33% | $243.6 |
| Percent of net revenues | 44% | | 18% | | 19% |

Our research and development (R&D) expenses consist principally of direct personnel costs, 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 advanced semiconductor process development, design automation and advanced package development for the benefit of each of our businesses.

We continue to focus our R&D investment principally in the areas of broadband communications and Internet infrastructure. The increase in our R&D expenses for fiscal 2001 primarily reflects higher headcount and personnel-related costs of our expanded development efforts and the accelerated launch of new products. The higher fiscal 2001 R&D expenses also reflect the increase in our engineering team resulting from the acquisitions of nine businesses during fiscal 2000.

The increase in R&D expenses for fiscal 2000 compared to fiscal 1999 primarily reflects higher headcount and

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personnel-related costs as we expanded our R&D efforts in the areas of Internet infrastructure and broadband communications. Subsequent to September 1999, our recruiting programs increased our engineering team by over 390 engineers, including approximately 290 engineers joining us through the acquisition of nine businesses. Our key product development efforts were targeted at client and multiport ADSL and G.shdsl products, home networking solutions, cable modems, CMOS imager solutions and broadband optical networking products.

**Selling, General and Administrative**

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Selling, general and administrative | $250.8 | 6% | $237.0 | 18% | $200.5 |
| Percent of net revenues | 30% | | 13% | | 16% |

Our selling, general and administrative (SG&A) expenses include personnel costs, sales representative commissions, advertising and other marketing costs. Our SG&A expenses also include costs of corporate functions including legal, accounting, treasury, human resources, real estate, information systems, customer service, sales, marketing, field application engineering and other services.

The increase in SG&A expenses for fiscal 2001 compared to fiscal 2000 primarily reflects the addition of the selling, marketing and administrative teams of the businesses we acquired during fiscal 2000 and the development of corporate infrastructure early in fiscal 2001 in anticipation of the planned separation of our Broadband Communications and Mindspeed Technologies businesses. SG&A expenses for fiscal 2001 also reflect provisions of $23.1 million for accounts receivable from slow-paying customers. The provision reflected an increase in past-due accounts which we estimated would ultimately be uncollectible. Excluding the effect of the provisions for uncollectible accounts, our SG&A expenses for fiscal 2001 compared to fiscal 2000 decreased by $10.7 million as a result of the cost-reduction initiatives we implemented during fiscal 2001.

The increase in SG&A expenses for fiscal 2000 as compared to fiscal 1999 resulted from our continued development of our sales, marketing and business support functions since our spin-off from Rockwell at the end of the fiscal 1999 first quarter. In particular, we invested in the expansion of our sales and marketing organizations to support the rapid sales growth experienced in fiscal 1999 and 2000. The increase also reflects higher sales representative commissions driven by revenue growth, the SG&A costs associated with the businesses we acquired in fiscal 2000, and the continued development of corporate infrastructure, including our information systems, human resources and finance teams.

**Amortization of Intangible Assets**

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Amortization of intangible assets | $324.8 | nm | $154.7 | nm | $8.4 |

nm = not meaningful

The higher amortization expense in the fiscal 2001 and 2000 periods resulted from the nine business acquisitions we completed during fiscal 2000. In connection with these acquisitions, we recorded an aggregate of $1.6 billion of identified intangible assets and goodwill. These assets are being amortized over their estimated lives (principally five years). Consequently, we expect to record amortization expense related to goodwill and intangible assets of approximately $330 million in fiscal 2002.

The recently-issued Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , addresses financial accounting and reporting for acquired goodwill and other intangible assets. Under SFAS 142, goodwill and intangible assets that have indefinite useful lives will not be amortized into results of operations, but instead will be tested at least annually for impairment and written down when impaired. We will be required to adopt the impairment provisions of SFAS 142 as of the beginning of fiscal 2003. However, SFAS 142 is immediately applicable to any goodwill and intangible assets we may acquire after June 30, 2001. Upon our adoption of SFAS 142, we will cease amortizing goodwill against our results of operations, reducing annual amortization expense by approximately $270 million. In addition, we will be required to evaluate goodwill for impairment as of October 1, 2002. If the recorded value of goodwill exceeds its estimated fair value at that date, we will write down the value of goodwill to estimated fair value. We are evaluating the impact of adopting SFAS 142.

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**Special Charges**

Special charges consist of the following:

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Asset impairments | $342.8 | nm | $ | nm | $ 20.0 |
| Restructuring charges | 20.1 | nm | | nm | 16.5 |
| Litigation | | nm | 35.0 | nm | |
| Separation costs | 15.7 | nm | | nm | |
| Other special costs | 11.0 | nm | | nm | |
| | $389.6 | | $35.0 | | $ 36.5 |

nm = not meaningful

***Asset Impairments***

During fiscal 2001, we recorded impairment charges totaling $342.8 million associated with manufacturing assets in our Broadband Communications segment. During the third quarter of fiscal 2001, we decided to realign our manufacturing and procurement strategies, accelerating our transition from volume digital CMOS manufacturing to a fabless CMOS business model.

We believe the decision to realign our manufacturing and procurement strategies made in the third quarter of fiscal 2001 and the resulting elimination of future investment in process technology and capacity during the transition period, together with the then-current and projected business conditions, indicated that the carrying value of the silicon wafer manufacturing facility and related wafer fabrication machinery and equipment at our Newport Beach, California facility (the wafer fabrication assets ) may have been impaired and that an impairment analysis should be performed. In performing the analysis for recoverability, we estimated the future cash flows expected to result from the manufacturing activities at the Newport Beach facility over a six-year period. This period reflected our expectation (as of the date we made the impairment analysis) of the period over which the wafer fabrication assets would generate cash flow during our transition to a fabless business. The estimated cash flows were based on declining volumes and average wafer prices for the existing products that we expected to manufacture at the Newport Beach facility during the transition period. The declines in volume and average wafer prices were consistent with historical trends and our decision to focus on existing specialty-process products based on our current process technology. Since the estimated undiscounted cash flows were less than the carrying value (approximately $410 million based on historical cost) of the wafer fabrication assets, we concluded that an impairment loss should be recognized. We recorded an impairment charge of $325.8 million, which was determined by comparing the estimated fair value of the wafer fabrication assets to their carrying value. The fair value of the assets was determined by computing the present value of the estimated future cash flows using a discount rate of 30%, which we believed was commensurate with the underlying risks associated with the projected cash flows. We believe the assumptions used in the discounted cash flow model represented a reasonable estimate of the fair value of the assets. The write-down established a new cost basis for the impaired assets, which would be depreciated based upon new estimated useful lives ranging from one to six years. The write-down of the wafer fabrication assets, net of the impact of using shorter estimated lives, reduced our quarterly depreciation expense by approximately $19 million. In March 2002, we contributed the Newport Beach, California wafer fabrication assets to Jazz, a new specialty foundry company, in exchange for $19.3 million in cash and a 45% equity interest in Jazz. We recorded a $2.6 million gain on this transaction.

Additionally, we recorded an impairment charge of $17.0 million in the third quarter of fiscal 2001 to write down the carrying value of an advance deposit to a third-party foundry. Under the terms of the advance deposit, the third-party foundry would repay the deposit as we purchased wafers from the foundry during a specified time period. As a result of the then-current and projected business conditions, we estimated that purchases during the remaining term of the arrangement with this foundry would be insufficient for us to fully recover the advance deposit.

In fiscal 1999, we recorded a $20.0 million impairment charge to further write down our Colorado Springs, Colorado wafer fabrication facilities, which we decided to close and dispose of during fiscal 1998. We distributed the Colorado Springs wafer fabrication facilities to Rockwell prior to our spin-off from Rockwell.

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***Restructuring Charges***

In fiscal 2001, we implemented a number of expense reduction and restructuring initiatives to more closely align our cost structure with the current business environment. The cost reduction initiatives include workforce reductions, temporary shutdowns of our manufacturing facilities, significant reductions in capital spending, the consolidation of certain facilities and salary reductions for our senior management team until we return to profitability. The costs and expenses associated with the restructuring activities are included in special charges in the consolidated statements of operations.

***2001 Global Restructuring Plan*** During the second quarter of fiscal 2001, we announced certain expense-reduction initiatives and a broad reduction in workforce affecting all areas of our operations and reducing our headcount by approximately 900 employees. These actions were the result of a comprehensive reassessment of our operations and business activities in order to focus investment and resources in areas that best support our strategic growth drivers. As part of the reassessment, we determined that we would explore alternatives to dispose of our digital imaging business and would also exit our board-level sub-assembly module business. We completed these restructuring actions in fiscal 2002.

In connection with this reduction in workforce, we terminated approximately 700 employees. The charges for the workforce reduction aggregated $6.8 million and were based upon estimates of the cost of severance benefits for the affected employees. These actions reduced our workforce in both the Broadband Communications and Mindspeed Technologies segments, including approximately 530 employees in our manufacturing operations. In addition, we recorded restructuring charges of $5.6 million for costs associated with the consolidation of certain facilities and lease cancellation and related costs.

Activity and liability balances related to these restructuring actions through September 30, 2001 are as follows (in thousands):

| | Workforce reductions | Facility and other | Total |
|---|---|---|---|
| Charged to costs and expenses | $ 6,776 | $ 5,584 | $ 12,360 |
| Cash payments | (4,155) | (223) | (4,378) |
| Restructuring balance, September 30, 2001 | $ 2,621 | $ 5,361 | $ 7,982 |

***Strategic Manufacturing Restructuring Plan*** During the third quarter of fiscal 2001, we realigned our manufacturing and procurement strategy to accelerate our transition to a fabless CMOS business model. In connection with this manufacturing realignment, we initiated a further reduction of our workforce, which we completed in the fourth quarter of fiscal 2001. In connection with the strategic manufacturing restructuring actions, we terminated approximately 400 employees and recorded charges aggregating $7.8 million. These charges were based upon estimates of the cost of severance benefits for the affected employees. These actions reduced our workforce in both the Broadband Communications and Mindspeed Technologies segments, including approximately 220 employees in our manufacturing operations.

Activity and liability balances related to the strategic manufacturing restructuring actions through September 30, 2001 are as follows (in thousands):

| | Workforce reductions |
|---|---|
| Charged to costs and expenses | $ 7,756 |
| Cash payments | (5,006) |
| Restructuring balance, September 30, 2001 | $ 2,750 |

We expect to pay a majority of the amounts accrued for the workforce reductions within one year. We expect to pay the obligations for the non-cancelable lease and other commitments over their respective contractual terms, which principally expire through fiscal 2005. Cash payments to complete the restructuring actions will be funded from available cash reserves and funds from operations, and are not expected to significantly impact our liquidity.

The fiscal 2001 restructuring initiatives and other expense reduction actions taken resulted in a quarterly reduction of manufacturing and operating expenses of approximately $60 million for the fourth quarter of fiscal 2001 as compared with the second quarter of fiscal 2001.

In fiscal 1999, we recorded additional restructuring charges of $16.5 million to complete an approximate 10% worldwide workforce reduction and other restructuring actions which we commenced in 1998. The 1999 charges include $15.6 million of additional costs relating to our voluntary early retirement program and $0.9 million to decommission equipment, activities at foreign subsidiaries and contract cancellations at our Colorado Springs wafer fabrication facilities. We completed these restructuring actions in fiscal 2000.

***Litigation***

In fiscal 2000, we recorded a special charge of $35.0 million representing the estimated amount of a settlement payment (in excess of amounts we previously recorded in fiscal 1998) to be made in connection with certain litigation based upon claims of patent infringement and other claims relating to our 56 Kbps modem products. In October 2000, we agreed to a settlement of the litigation, under which we subsequently paid $55.0 million in cash.

***Separation Costs***

In fiscal 2001, we incurred costs of $15.7 million related to the previously-announced separation of our Broadband Communications and Mindspeed Technologies businesses into two independent companies.

***Other Special Charges***

In connection with our fiscal 2001 restructuring actions and realigned manufacturing and procurement strategies, we recorded other special charges aggregating $11.0 million related to the disposal or write-off of certain assets.

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**Purchased In-Process Research and Development**

In connection with five of our fiscal 2000 business acquisitions, we recorded charges totaling $191.3 million for the fair value of purchased in-process research and development (IPRD). The following table summarizes the significant assumptions underlying the valuations related to IPRD at the time of the acquisitions.

| (in millions) | Date Acquired | IPRD | Estimated costs to complete projects | Discount rate applied to IPRD | Weighted-average cost of capital |
|---|---|---|---|---|---|
| Microcosm | January 2000 | $ 27.4 | $ 0.8 | 35% | 20% |
| Maker | March 2000 | 118.5 | 5.7 | 30% | 18% |
| HotRail | June 2000 | 26.1 | 11.7 | 34% | 24% |
| Novanet | September 2000 | 17.3 | 10.8 | 22% to 27% | 20% |
| NetPlane | September 2000 | 2.0 | 0.5 | 20% to 22% | 17% |

We believe the discount rates applied to the IPRD projects reflect the specific risks associated therewith. We are responsible for the amounts determined for IPRD and we believe the amounts are representative of fair values and do not exceed the amounts an independent party would pay for these projects at the dates of acquisition.

The IPRD projects are directed toward the development of integrated circuits and related software for communications applications. The development of these products is subject to significant risk due to the remaining effort required to achieve technical viability, rapidly changing customer requirements, evolving technical standards, and intense competition from semiconductor manufacturers in the United States and abroad. The remaining effort to complete the IPRD projects consists principally of design engineering and test activities to produce commercially viable semiconductor products that meet market requirements, including functionality and compliance with technical standards. In the event we are unable to complete the IPRD projects and deliver new products to the market on a timely basis, or to achieve market acceptance for the products we develop, we could lose market share or lose opportunities to capitalize on emerging markets, which could have a material and adverse impact on our business and operating results.

***Microcosm*** We identified and valued four IPRD projects, directed toward the development of high-performance programmable communications processors. Microcosm s IPRD projects ranged from 77% to 90% complete and averaged approximately 84% complete. One IPRD project, directed toward the development of an integrated transimpedance amplifier for applications such as synchronous optical networking/synchronous digital hierarchy (SONET/SDH) to 2.5 Gbps, represented 86% of the total value of IPRD acquired. This project was approximately 77% complete at the time of the acquisition and the engineering and test efforts to complete this project were initially expected to be completed during fiscal 2001. This project was abandoned in fiscal 2001 in favor of efforts focused on higher data-rate solutions.

***Maker*** We identified and valued seven IPRD projects, principally directed toward the development of high-performance programmable communications processors for processing and switching data, voice and video in broadband networks. Each project represented 10% to 26% of the total IPRD value. At the time of the acquisition, Maker s IPRD projects ranged from 55% to 92% complete and averaged approximately 75% complete. The projects were initially expected to be completed during fiscal 2001. Maker completed three IPRD projects during fiscal 2001 and the remaining IPRD projects were expected to be completed during fiscal 2002, with the exception of one project (which represented 18% of the IPRD value) which was cancelled in fiscal 2002.

***HotRail*** We identified and valued two IPRD projects, directed toward the development of integrated circuits for high-speed switching, interconnect and scalable processing in Internet infrastructure systems. One IPRD project, directed toward the development of scalable, high-speed switch fabric systems, represented 73% of the total value of IPRD acquired. This project was approximately 34% complete at the time of the acquisition and the engineering and test efforts to complete this project were initially expected to be completed during fiscal 2001. The switch fabric project was completed in fiscal 2002. The second IPRD project, directed toward the development of the HotRail Channel parallel CMOS transceiver, represented 27% of the total value of IPRD acquired. This project was approximately 93% complete at the time of the acquisition and the engineering and test efforts to complete this project were completed during fiscal 2001, consistent with our original expectations.

***Novanet*** We identified and valued three IPRD projects, directed toward the development of high-speed semiconductor solutions for ATM and packet-over-SONET applications. Novanet s IPRD projects ranged from 45%

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to 90% complete and averaged approximately 70% complete. One IPRD project, directed toward the development of a highly integrated telecommunications device providing full duplex mapping functions at the 2.5 Gbps data rate, represented 79% of the total value of IPRD acquired. This project was approximately 45% complete at the time of the acquisition and the engineering and test efforts to complete this project were expected to be completed in fiscal 2001. This project was cancelled during fiscal 2001 to permit development resources to be refocused on next-generation semiconductor products which we believe are better aligned with expected future demand. In June 2002, the Company decided to discontinue development of high-speed physical layer optical networking devices and closed the Novanet design center. The Company does not expect to generate significant future revenues from any of the acquired projects.

***NetPlane*** We identified and valued four IPRD projects, directed toward the development of network control software and subsystems, including advanced multiprotocol label switching software for optical Internet backbone equipment and an Internet protocol (IP) routing protocol product suite. NetPlane s IPRD projects ranged from 5% to 60% complete and averaged approximately 30% complete. One project, directed toward the development of an IP routing protocol product suite, represented 67% of the value of IPRD acquired. This project was approximately 25% complete at the time of acquisition, and the software development and testing efforts to complete this project were expected to be completed in fiscal 2001. This project was completed during fiscal 2001.

**Debt Conversion Costs**

During fiscal 2001, approximately $255.2 million principal amount of our 4¼% Convertible Subordinated Notes due 2006 were converted into approximately 11.0 million shares of our common stock at a cost to us of $42.6 million.

**Other Income, Net**

| (in millions) | 2001 | Change | 2000 | Change | 1999 |
|---|---|---|---|---|---|
| Other income, net | $0.4 | (94)% | $6.3 | 6% | $6.0 |

Other income, net for fiscal 2001 is comprised of investment income, interest income on invested cash balances and a $23.3 million gain on sale of marketable securities. Such other income is offset by interest expense on our convertible subordinated notes, a $4.1 million write-off of costs associated with a terminated credit facility, and a $13.1 million write-down of certain non-marketable investments.

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

In fiscal 2000, other income, net principally reflects net interest income resulting from both higher interest rates and larger invested cash balances, including a portion of the proceeds of the $650 million principal amount of our 4% Convertible Subordinated Notes due 2007 issued in February 2000. The fiscal 1999 period reflects gains on the sale of certain investments, which were partially offset by net interest expense resulting from lower invested cash balances.

**Provision (Benefit) for Income Taxes**

In fiscal 2001, we recorded an income tax benefit of $106.3 million, which reflects the value of our net loss to reduce our income taxes, net of the impact of the valuation allowance established against the deferred tax assets and the non-deductible costs for amortization of intangible assets. As a result of our large fiscal 2001 operating losses and our expectation of future operating results, we determined that it is more likely than not that a portion of the

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additional income tax benefits which arose during fiscal 2001 will not be realized. Consequently, we established a valuation allowance of $303.3 million for the portion of our deferred tax assets which we do not expect to realize through the reduction of future income tax payments. We believe the remaining portion of our deferred tax assets will be realized based on our current expectations of future earnings and tax planning strategies available to us. We do not expect to recognize any income tax benefits relating to future operating losses until we believe that such benefits are more likely than not to be realized. We expect foreign income taxes to be insignificant. Consequently, we expect our effective income tax rate will be approximately 0% for fiscal 2002.

For fiscal 2000, our provision for income taxes was $63.0 million. Exclusive of the non-deductible charges for IPRD and amortization of intangible assets resulting from our fiscal 2000 acquisitions, our effective tax rate for fiscal 2000 was approximately 28% of pre-tax income. This rate reflects the positive impact of state and federal research and experimentation tax credits available to us. In fiscal 1999, we recorded a provision for income taxes of $5.6 million, or approximately 30% of pre-tax income.

**Extraordinary Gain on Extinguishment of Debt**

During fiscal 2001, we purchased $35.0 million principal amount of our 4% Convertible Subordinated Notes due 2007 at prevailing market prices, resulting in a gain of $11.7 million. We have presented such gain in the consolidated statement of operations as an extraordinary item, net of income taxes of $4.4 million.

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**Quarterly Results of Operations**

The following table presents our operating results for each of the eight fiscal quarters in the period ended September 30, 2001. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited consolidated financial statements included in this report. In our opinion, all necessary adjustments, which consist only of normal and recurring accruals as well as the inventory write-downs, the write-off of purchased in-process research and development, special charges, debt conversion costs and the extraordinary gain on extinguishment of debt have been included to fairly present our unaudited quarterly results. The quarterly financial data for all periods have been restated to reflect the wireless communications business and Mexicali operations as discontinued operations. This data should be read together with our consolidated financial statements and the notes thereto included in this report.

| | Three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Dec. 31, 1999 | Mar. 31, 2000 | June 30, 2000 | Sept. 30, 2000 | Dec. 31, 2000 | Mar. 31, 2001 | June 30, 2001 | Sept. 30, 2001 |
| | (in thousands, except per share amounts) | | | | | | | |
| **Statement of Operations Data** | | | | | | | | |
| Net revenues | $434,493 | $ 419,630 | $451,980 | $484,513 | $ 341,843 | $ 204,420 | $ 157,836 | $ 142,957 |
| Cost of goods sold | 234,476 | 218,763 | 230,268 | 242,690 | 220,331 | 240,591 | 173,861 | 116,771 |
| Gross margin | 200,017 | 200,867 | 221,712 | 241,823 | 121,512 | (36,171) | (16,025) | 26,186 |
| Research and development | 68,419 | 77,771 | 82,019 | 94,646 | 91,620 | 99,414 | 90,557 | 90,351 |
| Selling, general and administrative | 56,801 | 54,649 | 59,143 | 66,396 | 64,363 | 71,666 | 63,377 | 51,402 |
| Amortization of intangible assets | 2,405 | 25,337 | 54,557 | 72,380 | 78,419 | 80,085 | 81,351 | 84,950 |
| Special charges | | | | 35,000 | 7,927 | 10,002 | 345,835 | 25,852 |
| Purchased in-process R&D | | 145,900 | 26,100 | 19,348 | | | | |
| Total operating expenses | 127,625 | 303,657 | 221,819 | 287,770 | 242,329 | 261,167 | 581,120 | 252,555 |
| Operating income (loss) | 72,392 | (102,790) | (107) | (45,947) | (120,817) | (297,338) | (597,145) | (226,369) |
| Debt conversion costs | | | | | (42,584) | | | |
| Other income (expense), net | 545 | 898 | 2,064 | 2,822 | (4,345) | (1,084) | (4,789) | 10,607 |
| Income (loss) before income taxes | 72,937 | (101,892) | 1,957 | (43,125) | (167,746) | (298,422) | (601,934) | (215,762) |
| Provision (benefit) for income taxes | 21,882 | 28,959 | 23,780 | (11,585) | (10,476) | (95,896) | 20 | 42 |
| Income (loss) from continuing operations | 51,055 | (130,851) | (21,823) | (31,540) | (157,270) | (202,526) | (601,954) | (215,804) |
| Discontinued operations | 776 | (1,491) | (31,498) | (25,555) | (49,590) | (59,485) | (142,986) | (23,003) |
| Income (loss) before | 51,831 | (132,342) | (53,321) | (57,095) | (206,860) | (262,011) | (744,940) | (238,807) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| extraordinary item | | | | | | | | |
| Extraordinary gain on extinguishment of debt | | | | | 7,284 | | | |
| Net income (loss) | $ 51,831 | $ (132,342) | $ (53,321) | $ (57,095) | $ (199,576) | $ (262,011) | $ (744,940) | $ (238,807) |
| Diluted income (loss) per share: | | | | | | | | |
| Continuing operations | $ 0.24 | $ (0.63) | $ (0.10) | (0.14) | $ (0.67) | $ (0.83) | $ (2.44) | $ (0.85) |
| Discontinued operations | | (0.01) | (0.14) | (0.11) | (0.21) | (0.25) | (0.58) | (0.10) |
| Extraordinary item | | | | | 0.03 | | | |
| Net income (loss) | $ 0.24 | $ (0.64) | $ (0.24) | $ (0.25) | $ (0.85) | $ (1.08) | $ (3.02) | $ (0.95) |
| Shares used in computing diluted income (loss) per share | 228,974 | 205,207 | 218,249 | 227,124 | 236,119 | 243,515 | 246,777 | 252,427 |

Our quarterly revenues generally increased through the fourth quarter of fiscal 2000, but commencing in the first quarter of fiscal 2001 our revenues declined as a result of reduced global demand for PCs and related peripheral devices, satellite set-top boxes and Internet infrastructure equipment. This decline became more pronounced in the fourth quarter of fiscal 2001, particularly in our Mindspeed Technologies segment. The decline in quarterly revenues, together with lower utilization of our manufacturing facilities and the inventory write-downs, caused a deterioration in gross margins as a percentage of net revenues.

Research and development expenses generally increased through the quarterly periods presented, reflecting our

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sustained investment in product development. Quarterly selling, general and administrative expenses generally increased due to the development of infrastructure in support of our sales growth and the planned separation of our Broadband Communications and Mindspeed Technologies businesses as well as our fiscal 2000 acquisitions. Our operating expenses declined in the second half of fiscal 2001 as a result of the cost reduction initiatives. Operating expenses (both research and development and selling, general and administrative) increased as a percentage of net revenues through the third quarter of fiscal 2001 primarily as a result of the decline in our net revenues.

In the second, third and fourth quarters of fiscal 2000, we recorded the IPRD charges and increased amortization of intangible assets as a result of our acquisition of nine businesses during those periods. In the fourth quarter of fiscal 2000, we also recorded a special charge related to the settlement of certain litigation. During each quarter of fiscal 2001 we recorded special charges for our restructuring initiatives and, in the fiscal 2001 third quarter, to write down the carrying value of manufacturing assets in our Broadband Communications segment.

Through the second quarter of fiscal 2001, we recognized income tax benefits for the value of our net losses to reduce our income taxes, net of the impact of non-deductible costs such as IPRD and amortization of intangible assets. Commencing in the third quarter of fiscal 2001, we ceased recognizing any tax benefit relating to our operating losses because we determined that it is more likely than not that the additional income tax benefits would not be realized.

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

**Liquidity and Capital Resources**

Cash used in operating activities was $202.4 million for fiscal 2001, compared to cash provided by operating activities of $211.3 million for fiscal 2000 and $299.2 million for fiscal 1999. Fiscal 2001 operating cash flows reflect our loss from continuing operations of $1.2 billion, offset by noncash charges (depreciation and amortization, special charges and other) of $914.8 million, and a net decrease in the non-cash components of our working capital of approximately $60.4 million. Before the effect of working capital changes, operating cash flow was $(262.8) million for fiscal 2001, compared to $366.9 million for fiscal 2000.

The fiscal 2001 working capital decreases include a $239.1 million decrease in net receivables, principally due to lower quarterly sales. Our allowance for doubtful accounts increased by $11.8 million during fiscal 2001, resulting from additional reserves taken for slow-paying accounts which we expected to be uncollectible. The working capital changes include a $22.8 million increase in net inventories (before the effect of inventory write-downs of $188.8 million). The working capital changes also include a reduction of accounts payable of $127.7 million, an $11.0 million decrease in deferred revenues and a decrease in accrued expenses and other current liabilities of $10.7 million resulting from lower materials purchases and decreased capital spending.

Cash used in investing activities of $303.9 million during fiscal 2001 included net purchases of marketable securities totaling $93.0 million. Capital expenditures totaled $107.3 million during fiscal 2001, primarily for investment in production and test facilities and corporate information systems. As a part of our expense reduction initiatives, we reduced capital expenditures to $8.7 million in the fourth quarter of fiscal 2001. In addition, we made payments for investments, advances and acquisitions totaling $106.1 million, including a vendor advance of $75.0 million, payments of $13.0 million in connection with business acquisitions, and $18.1 million of equity investments, principally in early-stage communications technology companies. Cash used in investing activities during fiscal 2000 consisted of routine capital expenditures of $214.7 million, payments for investments, advances and acquisitions totaling $182.9 million, and net sales of marketable securities of $13.2 million.

Cash used in financing activities of $44.8 million during fiscal 2001 principally consisted of $65.0 million paid in connection with the conversion and repurchase of a portion of our convertible subordinated notes. During fiscal

2001, approximately $255.2 million principal amount of our 4¼% Convertible Subordinated Notes were converted into approximately 11.0 million shares of common stock, at a cost to us of $42.6 million. Also during fiscal 2001, we purchased $35.0 million principal amount of our 4% Convertible Subordinated Notes at prevailing market prices, resulting in an extraordinary gain of $11.7 million. These costs were partially offset by proceeds of $20.2 million from the exercise of stock options. Cash provided by financing activities during fiscal 2000 of $747.7 million consisted of net proceeds from the issuance of $650 million principal amount of our 4% Convertible Subordinated Notes due 2007 and proceeds from the exercise of stock options of $116.7 million.

Our principal sources of liquidity are our existing cash reserves and available-for-sale marketable securities and cash generated from operations. Combined cash and cash equivalents and marketable securities at September 30, 2001 totaled $338.9 million compared to $944.4 million at September 30, 2000. Our working capital at September 30, 2001 was $442.4 million compared to $1.3 billion at September 30, 2000. The overall working capital decrease principally reflects cash used in operations and cash payments for capital expenditures, investments and advances and the inventory write-downs recorded during the year.

The dramatic changes in end-user demand from the levels we experienced in fiscal 2000 and the continued high levels of channel inventories have reduced visibility into future demand. These and other factors have continued to affect our revenues in fiscal 2002. The reduced level of revenues in relation to our operating costs including our continued substantial investment in research and development has and will continue to adversely affect our results of operations. Consequently, we anticipate that we will continue to experience negative cash flows from operations in the near term. During fiscal 2001 and 2002, we reduced our capital expenditures and implemented a number of expense reduction initiatives, including workforce reductions, temporary shutdowns of our manufacturing facilities, the consolidation of certain facilities and salary reductions of 10% for senior management.

We believe that our existing sources of liquidity, along with cash expected to be generated from operations, will be sufficient to fund our operations, research and development efforts, anticipated capital expenditures and additional consideration that may be payable to iCompression for at least the next twelve months. Although reduced capital expenditures are a key component of our realigned manufacturing and procurement strategy, we will need to continue a focused program of capital expenditures to meet our research and development and corporate requirements. We may also consider acquisition opportunities to extend our technology portfolio and design expertise and to expand our product offerings. In order to fund capital expenditures, increase our working capital or complete any acquisitions, we may seek to obtain additional debt financing or issue additional shares of our common stock. However, we cannot assure you that such financing will be available to us on favorable terms, or at all.

**Recent Accounting Standards**

See Note 2 of Notes to Consolidated Financial Statements.

**Quantitative and Qualitative Disclosures About Market Risk**

Our financial instruments include cash and cash equivalents, marketable securities and long-term debt. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our

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investment portfolio. Consequently, we invest with only high-credit-quality issuers and we limit the amount of our credit exposure to any one issuer. We do not use derivative instruments for speculative or investment purposes.

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of September 30, 2001, the carrying value of our cash and cash equivalents approximates fair value.

Our marketable debt securities (consisting of commercial paper, corporate bonds and government securities) principally have remaining terms of two years or less. Consequently, such securities are not subject to significant interest rate risk. All of our marketable securities are classified as available for sale and, as of September 30, 2001, unrealized gains of $1.6 million (net of related income taxes of $1.2 million) on these securities are included in accumulated other comprehensive income.

Our long-term debt consists of convertible subordinated notes with interest at fixed rates. Consequently, we do not have significant cash flow exposure on our long-term debt. However, the fair value of our convertible subordinated notes is subject to significant fluctuation due to their convertibility into shares of our common stock.

The following table shows the fair values of our investments and long-term debt as of September 30, 2001:

| (in thousands) | **Carrying Value** | **Fair Value** |
|---|---|---|
| Cash and cash equivalents | $ 182,260 | $ 182,260 |
| Marketable debt securities | 156,660 | 156,660 |
| Long-term debt | 709,849 | 398,311 |

We transact business in various foreign currencies, and we have established a foreign currency hedging program utilizing foreign currency forward exchange contracts to hedge certain foreign currency transaction exposures (principally Japanese yen). Under this program, we seek to offset foreign currency transaction gains and losses with gains and losses on the forward contracts, so as to mitigate our overall risk of foreign transaction gains and losses. We do not enter into forward contracts for speculative or trading purposes.

At September 30, 2001, we held foreign currency forward exchange contracts (to sell Japanese yen at specified rates) having an aggregate notional amount of approximately 574 million yen, at a notional weighted average exchange rate of approximately 116.2 yen to the dollar. The net unrealized gain/loss on the forward contracts outstanding at September 30, 2001 was not material to our consolidated financial statements. Based on our overall currency rate exposure at September 30, 2001, a 10 percent change in currency rates would not have a material effect on our consolidated financial position, results of operations or cash flows.

The table below provides information as of September 30, 2001 about our foreign currency forward exchange contracts. The table presents the notional amounts (the U.S. dollar equivalent, based on the contract exchange rates) and the contract foreign currency exchange rates.

| (dollars in thousands) | **Notional Amount** | **Contract Rate Per US $1.00** | **Estimated Fair Value** |
|---|---|---|---|
| Foreign currency forward exchange contracts: | | | |
| Japanese yen | $ 4,938 | 116.19 | $ 124 |

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**Financial Statements and Supplementary Data**

**CONEXANT SYSTEMS, INC.**

**CONSOLIDATED BALANCE SHEETS**
**(in thousands, except per share amounts)**

| | September 30, | |
|---|---|---|
| | **2001** | **2000** |
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 182,260 | $ 831,100 |
| Short-term investments | 156,660 | 17,397 |
| Receivables, net of allowance of $15,000 (2001) and $3,157 (2000) | 92,931 | 355,088 |
| Inventories | 85,014 | 251,019 |
| Deferred income taxes | 75,710 | 95,260 |
| Other current assets | 51,414 | 61,438 |
| Current assets of discontinued operations | 81,362 | 162,840 |
| Total current assets | 725,351 | 1,774,142 |
| Marketable securities | | 95,876 |
| Property, plant and equipment, net | 217,886 | 565,084 |
| Goodwill and intangible assets, net | 1,191,429 | 1,433,699 |
| Other assets | 264,529 | 208,995 |
| Deferred income taxes | 183,444 | 1,286 |
| Non-current assets of discontinued operations | 232,841 | 337,115 |
| Total assets | $ 2,815,480 | $ 4,416,197 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **Current Liabilities** | | |
| Accounts payable | $ 95,488 | $ 228,665 |
| Deferred revenue | 26,583 | 37,554 |
| Accrued compensation and benefits | 38,044 | 69,187 |
| Other current liabilities | 100,062 | 88,232 |
| Current liabilities of discontinued operations | 22,820 | 31,370 |
| Total current liabilities | 282,997 | 455,008 |
| Convertible subordinated notes | 709,849 | 999,997 |
| Other liabilities | 45,652 | 50,666 |
| Non-current liabilities of discontinued operations | 3,806 | 3,767 |
| Total liabilities | 1,042,304 | 1,509,438 |
| Commitments and contingencies | | |
| **Shareholders Equity** | | |
| Preferred and junior preferred stock (No par value, 25,000 shares authorized, no shares issued or outstanding) | | |
| Common stock, $1.00 par value: 1,000,000 authorized shares; 253,900 (2001) and 231,164 (2000) issued shares | 253,900 | 231,164 |
| Additional paid-in capital | 3,113,205 | 2,775,115 |
| Accumulated deficit | (1,566,209) | (120,875) |
| Accumulated other comprehensive income (loss) | (17,204) | 47,295 |

| | | |
|---|---|---|
| Treasury stock, at cost: 41 (2001) and 30 (2000) shares | (1,807) | (1,619) |
| Unearned compensation | (8,709) | (24,321) |
| Total shareholders equity | 1,773,176 | 2,906,759 |
| Total liabilities and shareholders equity | $ 2,815,480 | $4,416,197 |

See accompanying notes to consolidated financial statements.

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**CONEXANT SYSTEMS, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(in thousands, except per share amounts)**

| | Years Ended September 30, | | |
|---|---|---|---|
| | **2001** | **2000** | **1999** |
| Net revenues | $ 847,056 | $ 1,790,616 | $ 1,268,099 |
| Cost of goods sold | 751,554 | 926,197 | 766,553 |
| Gross margin | 95,502 | 864,419 | 501,546 |
| Operating expenses: | | | |
| Research and development | 371,942 | 322,855 | 243,585 |
| Selling, general and administrative | 250,808 | 236,989 | 200,527 |
| Amortization of intangible assets | 324,805 | 154,679 | 8,364 |
| Special charges | 389,616 | 35,000 | 36,474 |
| Purchased in-process research and development | | 191,348 | |
| Total operating expenses | 1,337,171 | 940,871 | 488,950 |
| Operating income (loss) | (1,241,669) | (76,452) | 12,596 |
| Debt conversion costs | (42,584) | | |
| Other income, net | 389 | 6,329 | 5,989 |
| Income (loss) before income taxes | (1,283,864) | (70,123) | 18,585 |
| Provision (benefit) for income taxes | (106,310) | 63,036 | 5,575 |
| Income (loss) from continuing operations | (1,177,554) | (133,159) | 13,010 |
| Loss from discontinued operations, net of income taxes | (275,064) | (57,768) | (81) |
| Income (loss) before extraordinary item | (1,452,618) | (190,927) | 12,929 |
| Extraordinary gain on extinguishment of debt, net of income taxes | 7,284 | | |
| Net income (loss) | $ (1,445,334) | $ (190,927) | $ 12,929 |
| Basic income (loss) per share: | | | |
| Continuing operations | $ (4.81) | $ (0.63) | $ 0.07 |
| Discontinued operations | (1.13) | (0.27) | |
| Extraordinary item | 0.03 | | |
| Net income (loss) | $ (5.91) | $ (0.90) | $ 0.07 |
| Diluted income (loss) per share: | | | |
| Continuing operations | $ (4.81) | $ (0.63) | $ 0.06 |
| Discontinued operations | (1.13) | (0.27) | |
| Extraordinary item | 0.03 | | |
| Net income (loss) | $ (5.91) | $ (0.90) | $ 0.06 |
| Number of shares used in per share computation: | | | |
| Basic | 244,711 | 211,840 | 192,551 |

| | | | |
|---|---|---|---|
| Diluted | 244,711 | 211,840 | 203,484 |

See accompanying notes to consolidated financial statements.

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**CONEXANT SYSTEMS, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands)**

| | Years Ended September 30, | | |
|---|---|---|---|
| | **2001** | **2000** | **1999** |
| **Cash Flows From Operating Activities** | | | |
| Income (loss) from continuing operations | $(1,177,554) | $(133,159) | $ 13,010 |
| Adjustments required to reconcile income (loss) from continuing operations to net cash provided by (used in) operating activities: | | | |
| Depreciation | 116,694 | 131,024 | 162,044 |
| Amortization of intangible assets | 324,805 | 154,679 | 8,364 |
| Asset impairments | 342,791 | | 20,000 |
| Provision for losses on accounts receivable | 23,081 | (1,472) | 3,775 |
| Inventory provisions | 205,884 | 4,639 | 7,537 |
| Deferred income taxes | (146,482) | (29,167) | 9,940 |
| Stock compensation | 15,168 | 9,491 | 19,570 |
| Purchased in-process research and development | | 191,348 | |
| Special charges litigation | | 35,000 | |
| Debt conversion costs | 42,584 | | |
| Other noncash charges, net | 7,319 | 4,533 | 6,286 |
| Changes in assets and liabilities, net of acquisitions: | | | |
| Receivables | 239,088 | (139,122) | (56,693) |
| Inventories | (39,879) | (56,888) | (23,503) |
| Accounts payable | (127,668) | (49,955) | 114,817 |
| Deferred revenue | (10,952) | 14,974 | 4,377 |
| Accrued expenses and other current liabilities | (10,731) | 97,871 | 46,299 |
| Other | (6,527) | (22,482) | (36,634) |
| Net cash provided by (used in) operating activities | (202,379) | 211,314 | 299,189 |
| **Cash Flows From Investing Activities** | | | |
| Purchase of marketable securities | (531,201) | (6,011) | |
| Sale of marketable securities | 438,211 | 19,206 | |
| Capital expenditures | (107,296) | (214,694) | (119,425) |
| Proceeds from sale of assets | 2,522 | | |
| Acquisitions of businesses, net of cash acquired | (12,994) | (8,682) | |
| Investments in and advances to businesses | (93,112) | (174,258) | (18,400) |
| Net cash used in investing activities | (303,870) | (384,439) | (137,825) |
| **Cash Flows From Financing Activities** | | | |
| Proceeds from issuance of convertible subordinated notes, net of issuance costs | | 630,992 | 339,574 |
| Proceeds from exercise of stock options | 20,216 | 116,697 | 23,408 |
| Payment of debt conversion costs | (42,584) | | |
| Repurchase of convertible subordinated notes | (22,400) | | |
| Payment of short-term debt | | | (14,075) |
| Net transfers to Rockwell | | | (39,909) |
| Net cash provided by (used in) financing activities | (44,768) | 747,689 | 308,998 |
| Net cash used in discontinued operations | (97,823) | (141,980) | (85,846) |

| | | | |
|---|---|---|---|
| Net increase (decrease) in cash and cash equivalents | (648,840) | 432,584 | 384,516 |
| Cash and cash equivalents at beginning of period | 831,100 | 398,516 | 14,000 |
| Cash and cash equivalents at end of period | $ 182,260 | $ 831,100 | $ 398,516 |