LSI LOGIC CORP
Form 10-Q
May 13, 2005

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended April 3, 2005

OR

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

For the transition period from _______ to ________

Commission File Number: 1-10317

LSI LOGIC CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**94-2712976**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

1621 Barber Lane
Milpitas, California 95035
(Address of principal executive offices)
(Zip code)

(408) 433-8000
(Registrant s telephone number, including area code)

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

YES þ NO o

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

As of May 5, 2005, there were 387,793,555 shares of the registrant s Common Stock, $.01 par value, outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

LSI LOGIC CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEETS (UNAUDITED)

	March 31, 2005	December 31, 2004
	(In thousands, except per-share amounts)	
Assets		
Cash and cash equivalents	$ 264,734	$ 218,723
Short-term investments	601,189	595,862
Accounts receivable, less allowances of $10,446 and $12,545	259,479	272,065
Inventories	203,366	218,900
Deferred tax assets	5,654	5,661
Prepaid expenses and other current assets	53,255	54,076
Total current assets	1,387,677	1,365,287
Property and equipment, net	301,631	311,916
Intangibles, net	90,838	108,457
Goodwill	967,338	973,130
Deferred tax assets	5,014	5,044
Other assets	110,164	110,167
Total assets	$ 2,862,662	$ 2,874,001
Liabilities and Stockholders Equity		
Accounts payable	$ 115,778	$ 122,422
Accrued salaries, wages and benefits	60,074	58,516
Other accrued liabilities	133,753	142,278
Income taxes payable	76,869	72,935
Current portion of long-term obligations	32	129
Total current liabilities	386,506	396,280
Long-term debt	779,758	781,846
Tax related liabilities and other	77,027	77,570
Total long-term obligations and other liabilities	856,785	859,416
Commitments and contingencies (Notes 10 and 11)		
Minority interest in subsidiary	253	259

Stockholders equity:		
Preferred shares; $.01 par value; 2,000 shares authorized, none outstanding		
Common stock; $.01 par value; 1,300,000 shares authorized; 387,764 and 387,490 shares outstanding	3,878	3,875
Additional paid-in capital	2,976,912	2,969,478
Deferred stock compensation	(13,582)	(8,936)
Accumulated deficit	(1,379,602)	(1,384,321)
Accumulated other comprehensive income	31,512	37,950
Total stockholders equity	1,619,118	1,618,046
Total liabilities and stockholders equity	$ 2,862,662	$ 2,874,001

The accompanying notes are an integral part of these Consolidated Condensed Financial Statements.

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LSI LOGIC CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31,	
	2005	2004
	(In thousands, except per share amounts)	
Revenues	$ 450,007	$ 452,357
Cost of revenues	259,740	250,925
Gross profit	190,267	201,432
Research and development	99,237	108,941
Selling, general and administrative	58,140	61,158
Restructuring of operations and other items, net	1,533	(598)
Amortization of non-cash deferred stock compensation (*)	1,455	1,826
Amortization of intangibles	17,613	18,274
Income from operations	12,289	11,831
Interest expense	(6,710)	(5,912)
Interest income and other, net	5,390	9,166
Income before income taxes	10,969	15,085
Provision for income taxes	6,250	6,000
Net income	$ 4,719	$ 9,085
Net income per share:		
Basic	$ 0.01	$ 0.02
Diluted	$ 0.01	$ 0.02
Shares used in computing per share amounts:		
Basic	387,664	381,639
Diluted	390,458	389,882

(*) Amortization of non-cash deferred stock compensation, if not shown separately, would have been included in cost of revenues, research and development and selling, general and administrative expenses as shown below:

	Three months ended March 31, 2005	2004
	(In thousands)	
Cost of revenues	$ 161	$ 50
Research and development	835	1,181
Selling, general and administrative	459	595
Total	$ 1,455	$ 1,826

The accompanying notes are an integral part of these Consolidated Condensed Financial Statements.

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LSI LOGIC CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31, 2005	2004
	(In thousands)	
Operating activities:		
Net income	$ 4,719	$ 9,085
Adjustments:		
Depreciation and amortization	40,765	46,116
Amortization of non-cash deferred stock compensation	1,455	1,826
Non-cash restructuring and other items	849	2,229
Gain on sale and exchange of equity securities		(3,000)
Gain on sale of property and equipment	(54)	(3,101)
Changes in deferred tax assets and liabilities	37	520
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Accounts receivable	12,576	(15,368)
Inventories	15,534	(6,190)
Prepaid expenses and other assets	(5,115)	12,529
Accounts payable	(9,466)	(12,761)
Accrued and other liabilities	(1,969)	(21,778)
Net cash provided by operating activities	59,331	10,107
Investing activities:		
Purchase of debt securities available-for-sale	(112,325)	(229,440)
Maturities and sales of debt securities available-for-sale	102,313	189,040
Purchases of equity securities		(2,250)
Purchases of property, equipment and software	(8,433)	(11,557)
Proceeds from sale of property and equipment	1,411	4,014
Adjustment to goodwill acquired in a prior year for resolution of a pre-acquisition income tax contingency	5,792	
Increase in non-current assets and deposits		(23)
Decrease in non-current assets and deposits		27,753
Acquisition of companies, net of cash acquired		(4,777)
Increase in a payable to acquire a company		17,592
Net cash used in investing activities	(11,242)	(9,648)
Financing activities:		
Issuance of common stock	1,354	3,548
Purchase of minority interest in subsidiary		(1,059)
Repayment of debt obligations	(97)	(122)

Net cash provided by financing activities	1,257	2,367
Effect of exchange rate changes on cash and cash equivalents	(3,335)	906
Increase in cash and cash equivalents	46,011	3,732
Cash and cash equivalents at beginning of period	218,723	269,682
Cash and cash equivalents at end of period	$ 264,734	$ 273,414

The accompanying notes are an integral part of these Consolidated Condensed Financial Statements.

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LSI LOGIC CORPORATION

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

In the opinion of LSI Logic Corporation (the Company or LSI), the accompanying unaudited consolidated condensed financial statements contain all adjustments (consisting only of normal recurring adjustments and restructuring and other items, net as discussed in Note 3 to the Unaudited Consolidated Condensed Financial Statements, hereafter referred to as the Notes), necessary to state fairly the financial information included herein. While the Company believes that the disclosures are adequate to make the information not misleading, it is suggested that these financial statements be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

For financial reporting purposes, the Company reports on a 13 or 14-week quarter with a year ending December 31. The current quarter ended April 3, 2005. For presentation purposes, the consolidated condensed financial statements refer to the calendar quarters for convenience. The results of operations for the quarter ended April 3, 2005, are not necessarily indicative of the results to be expected for the full year. The current quarter ended April 3, 2005, was a 13-week quarter while the same quarter of the previous year was a 14-week quarter.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated condensed financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). This statement eliminates the alternative to use the intrinsic value method of accounting for stock options issued to employees. This statement requires entities to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant date fair value of those awards. This statement applies to all awards granted, modified, repurchased or cancelled after the effective date. In addition, compensation cost will be recognized on or after the effective date for the portion of outstanding awards for which the requisite service has not been rendered, based on the grant date fair value of those awards calculated under SFAS No. 123 for pro forma disclosures. This statement also requires additional disclosures in the notes to the consolidated financial statements. On April 14, 2005, the Securities and Exchange Commission (SEC) announced the adoption of a rule that defers the required effective date of SFAS No. 123R until the beginning of the first fiscal year beginning after June 15, 2005. The Company expects to apply this statement beginning in the first fiscal quarter of 2006. The Company is currently evaluating the impact of adopting this statement; however, the Company expects that it will have a significant impact on our consolidated balance sheet and statement of operations. The exact impact on the Company s financial statements will be dependent on a number of factors including the transition method, the option-pricing model used to compute fair value and the inputs to that model such as volatility and expected life. The pro forma disclosures of the impact of SFAS No. 123 provided in Note 2 may not be representative of the impact of adopting this statement.

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On March 29, 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment. This statement expresses views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB No. 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis (MD&A) subsequent to adoption of SFAS No. 123R. The Company is currently evaluating the impact of adopting this statement; however, the Company expects that the adoption of SFAS No. 123R and the related interpretations in SAB No. 107 will have a significant impact on the Company s consolidated balance sheet and statement of operations.

In March 2005, the FASB issued FASB Interpretation No. 47 (FIN No. 47), Accounting for Conditional Retirement Obligations an interpretation of SFAS No. 143. This interpretation clarifies the timing of when a liability should be recognized for legal obligations associated with the retirement of a tangible long-lived asset. In addition, the interpretation clarifies the treatment when there is insufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 is effective no later than December 31, 2005. Retrospective application for interim financial information is permitted but is not required. Early adoption is encouraged. The adoption of this standard is not expected to have a material impact on the Company s consolidated balance sheet or statement of operations.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29. This statement amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated balance sheet or statement of operations.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4. This statement clarifies the accounting for abnormal amounts of facility expense, freight, handling costs and wasted materials (spoilage) to require them to be recognized as current-period charges. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated balance sheet or statement of operations.

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Act). The Act introduced a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. The Company has yet to complete its evaluation of the foreign earnings repatriation provision within the Act. At this time the Company has not been able to reasonably estimate the income tax effect of the foreign earnings repatriation provision. The Company plans to complete its evaluation in the second half of 2005.

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF No. 03-01 provides guidance on recording other-than-temporary impairments of cost-method investments and requires additional disclosures for those investments. In September 2004, a FASB Staff Position was issued that delays the recognition and measurement guidance in EITF No. 03-01 until the final issuance of FASB Staff Position Issue 03-01 a. The adoption of the recognition and measurement provisions is not expected to have a material impact on the Company s consolidated balance sheet or statement of operations.

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NOTE 2 STOCK-BASED COMPENSATION

The following table provides pro forma disclosures as if the Company had recorded compensation costs based on the estimated grant date fair value, as defined by the SFAS No. 123, for awards granted under its stock option and stock purchase plans. The estimated weighted-average grant date fair value, as defined by SFAS No. 123, was calculated using the Black-Scholes model. The Black-Scholes model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company s stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated grant date fair value.

	Three months ended March 31,	
	2005	2004
	(In thousands, except per share amounts)	
Net income, as reported	$ 4,719	$ 9,085
Add: Amortization of non-cash deferred stock compensation expense determined under the intrinsic value method as reported in net income, net of related tax effects *	296	1,274
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(18,039)	(37,841)
Pro forma net loss	$ (13,024)	$ (27,482)
Income/(loss) per share:		
Basic-as reported	$ 0.01	$ 0.02
Basic-pro forma	$ (0.03)	$ (0.07)
Diluted-as reported	$ 0.01	$ 0.02
Diluted-pro forma	$ (0.03)	$ (0.07)

* This amount excludes amortization of non-cash deferred stock compensation on restricted stock awards.

The pro forma disclosure provided above may not be representative of the effect of applying SFAS No. 123R. See further discussion in Recent Accounting Pronouncements in Note 1.

NOTE 3 RESTRUCTURING AND OTHER ITEMS

The Company recorded charges of $1.5 million in restructuring of operations and other items for the three months ended March 31, 2005, primarily in the Semiconductor segment. The Company recorded a net gain of $0.6 million in restructuring of operations and other items during the first quarter of 2004, primarily in the Semiconductor segment. For a complete discussion of the 2004 restructuring actions, please refer to the Company s Annual Report on Form 10-K for fiscal year 2004.

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Restructuring and impairment of long-lived assets:

First quarter of 2005:

The Company recorded an expense of $0.8 million for the write-down of purchased software that will not be used. An expense of $0.3 million was recorded to reflect the change in time value of accruals for facility lease termination costs, net of adjustments for changes in sublease assumptions for certain previously accrued facility lease termination costs. Additional non-manufacturing facilities were consolidated during the first quarter of 2005 and an expense of $0.4 million was recorded as the leased facilities ceased being used.

Assets held for sale of $10 million and $11 million were included as a component of prepaid expenses and other current assets as of March 31, 2005, and December 31, 2004, respectively. Assets classified as held for sale are not depreciated. The fair values of impaired equipment and facilities were researched and estimated by management. Given that current market conditions for the sale of older fabrication facilities and related equipment may fluctuate, there can be no assurance that the Company will realize the current net carrying value of the assets held for sale. The Company reassesses the realizability of the carrying value of these assets at the end of each quarter until the assets are sold or otherwise disposed of and additional adjustments may be necessary.

The following table sets forth the Company s restructuring reserves as of December 31, 2004 and March 31, 2005, which are included in other accrued liabilities on the balance sheet:

	Balance at December 31, 2004	Restructuring Expense Q1 2005	Utilized during Q1 2005	Balance at March 31, 2005
	(In thousands)			
Write-down of excess assets and decommissioning costs (a)	$ 1,207	$ 796	$ (1,271)	$ 732
Lease terminations (b)	20,065	738	(2,691)	18,112
Facility closure and other exit costs (c)	543		(476)	67
Payments to employees for severance (d)	7,408	(1)	(4,250)	3,157
Total	$ 29,223	$ 1,533	$ (8,688)	$ 22,068

(a) The amounts utilized in 2005 reflect $0.8 million of non-cash write-downs of long-lived assets in the U.S. due to impairment and $0.5 million in cash payments to decommission and sell assets. The write-downs of long-lived assets were accounted for as a reduction of the assets and did not result in a liability. The $0.7 million balance as of March 31, 2005, relates to machinery and equipment decommissioning costs in the U.S. and estimates for selling costs for assets held for sale and is expected to be utilized during 2005.

(b) Amounts utilized represent cash payments. The balance remaining for real estate lease terminations will be paid during the remaining terms of these contracts, which extend through 2011.

(c) Amounts utilized represent cash payments. The balance remaining for facility closure and other exit costs will be paid during 2005.

(d) Amounts utilized represent cash severance payments to 102 employees during the three months ended March 31, 2005. The balance remaining for severance is expected to be paid by the end of 2005.

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NOTE 4 INVESTMENTS

	March 31, 2005	December 31, 2004
	(In thousands)	
Available-for-sale debt securities		
Asset and mortgage-backed securities	$ 276,778	$ 292,898
U.S. government and agency securities	256,078	234,787
Corporate and municipal debt securities	68,333	68,177
Total short-term investments	$ 601,189	$ 595,862
Long-term investments in equity securities		
Marketable equity securities	$ 26,972	$ 28,372
Non-marketable equity securities	9,307	9,307
Total long-term investments in equity securities	$ 36,279	$ 37,679

An unrealized gain on investments in available-for-sale debt and equity securities of $9 million, net of the related tax effect of $5 million, and an unrealized gain of $12 million, net of the related tax effect of $6 million, was included in accumulated other comprehensive income as of March 31, 2005, and December 31, 2004, respectively. Net realized (losses)/gains on sales of investments in available-for-sale debt securities were ($0.3) million and $1 million for the three months ended March 31, 2005, and 2004, respectively.

There was no realized gain or loss associated with marketable and non-marketable available-for-sale equity securities during the first quarter of 2005. The Company realized a $3 million pre-tax gain associated with marketable available-for-sale equity securities of a certain technology company that was acquired by another technology company in the first quarter of 2004.

The following table includes the details of pre-tax losses related to investments in equity securities that the Company has recorded during the three months ended March 31, 2005, and 2004. Management believed that the declines in value were other than temporary.

	Non-marketable equity investments	Marketable equity investments
	(in millions)	
Pre-tax loss:		
Three months ended March 31, 2005	$	$
Pre-tax loss:		
Three months ended March 31, 2004	$ 1.0	$

Total carrying value of impaired investments as of March 31, 2005	$	2.4	$

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NOTE 5 BALANCE SHEET DETAIL

	March 31, 2005	December 31, 2004
	(In thousands)	
Cash and cash equivalents:		
Cash in financial institutions	$ 26,168	$ 51,172
Cash equivalents	238,566	167,551
	$ 264,734	$ 218,723
Inventories:		
Raw materials	$ 19,984	$ 20,022
Work-in-process	92,417	106,818
Finished goods	90,965	92,060
	$ 203,366	$ 218,900

The changes in the carrying amount of goodwill for the three months ended March 31, 2005, as follows (in thousands):

	Semiconductor Segment	Storage Systems segment	Total
Balance as of December 31, 2004	$ 892,497	$ 80,633	$ 973,130
Adjustment to goodwill acquired in a prior year for cash received from the resolution of a pre-acquisition income tax contingency	(5,792)		(5,792)
Balance as of March 31, 2005	$ 886,705	$ 80,633	$ 967,338

The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or sooner if events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment, if any, would be determined in accordance with SFAS No. 142, which uses a fair value model for determining the carrying value of goodwill. See the Company s Annual Report on Form 10-K for further discussion.

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NOTE 6 DEBT

	Maturity	Interest Rate	Conversion Price	March 31, 2005	December 31, 2004
				(In thousands)	
2003 Convertible Subordinated Notes	May, 2010	4%	$ 13.4200	$ 350,000	$ 350,000
2001 Convertible Subordinated Notes	November, 2006	4%	$ 26.3390	421,500	421,500
Deferred gain on terminated swaps				8,258	10,346
Capital lease obligations				32	129
				779,790	781,975
Current portion of long-term obligations				(32)	(129)
Long-term debt				$ 779,758	$ 781,846

NOTE 7 RECONCILIATION OF BASIC AND DILUTED INCOME PER SHARE

A reconciliation of the numerators and denominators of the basic and diluted income per share computations are as follows:

	Three Months Ended March 31, 2005			2004		
	Income*	Shares+	Per-Share Amount	Income*	Shares+	Per-Share Amount
	(In thousands except per share amounts)					
Basic EPS:						
Net income available to common stockholders	$ 4,719	387,664				