LSI CORP
Form 10-Q
November 07, 2008

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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 September 28, 2008

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 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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of November 3, 2008, there were 645,085,812 shares of the registrant s Common Stock, $.01 par value, outstanding.

LSI CORPORATION
Form 10-Q
For the Quarter Ended September 28, 2008
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FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words estimate, plan, intend, expect, anticipat believe and similar words are intended to identify forward-looking statements. Although we believe our expectations are based on reasonable assumptions, our actual results could differ materially from those projected in the forward-looking statements. We have described in Part II, Item 1A- Risk Factors a number of factors that could cause our actual results to differ from our projections or estimates. Except where otherwise indicated, the statements made in this report are made as of the date we filed this report with the Securities and Exchange Commission and should not be relied upon as of any subsequent date. We expressly disclaim any obligation to update the information in this report, except as may otherwise be required by law.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

LSI CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 28, 2008	December 31, 2007
	(In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	$ 784,910	$ 1,021,569
Short-term investments	389,017	376,028
Accounts receivable, less allowances of $11,191 and $10,192	401,101	406,368
Inventories	209,958	240,842
Prepaid expenses and other current assets	174,587	147,751
Total current assets	1,959,573	2,192,558
Property and equipment, net	234,028	229,732
Other intangible assets, net	1,128,590	1,225,196
Goodwill	537,517	499,551
Other assets	265,741	249,353
Total assets	$ 4,125,449	$ 4,396,390
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 237,397	$ 329,444
Accrued salaries, wages and benefits	141,328	118,990
Other accrued liabilities	229,866	298,343
Income taxes payable	24,706	15,679
Total current liabilities	633,297	762,456
Long-term debt	715,595	717,967
Pension, post-retirement and other benefits	124,051	137,543
Income taxes payable non-current	206,307	185,036
Other non-current liabilities	90,372	108,143
Total long-term obligations and other liabilities	1,136,325	1,148,689
Commitments and contingencies (Note 13)		
Minority interest in subsidiary	265	249
Stockholders equity:		
Preferred stock, $.01 par value: 2,000 shares authorized; none outstanding		
Common stock, $.01 par value: 1,300,000 shares authorized; 644,432 and 680,595 shares outstanding	6,444	6,806

Additional paid-in capital	6,035,946	6,152,421
Accumulated deficit	(3,754,426)	(3,738,522)
Accumulated other comprehensive income	67,598	64,291
Total stockholders equity	2,355,562	2,484,996
Total liabilities and stockholders equity	$ 4,125,449	$ 4,396,390

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

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LSI CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(In thousands, except per share amounts)			
Revenues	$ 714,308	$ 727,415	$ 2,067,118	$ 1,862,769
Cost of revenues	416,891	479,550	1,225,252	1,268,418
Gross profit	297,417	247,865	841,866	594,351
Research and development	169,551	182,291	509,383	488,071
Selling, general and administrative	103,744	104,518	307,267	280,931
Restructuring of operations and other items, net	1,586	101,231	26,869	119,071
Acquired in-process research and development				182,900
Income/(loss) from operations	22,536	(140,175)	(1,653)	(476,622)
Interest expense	(8,993)	(9,033)	(26,930)	(21,972)
Interest income and other, net	8,028	11,808	30,879	33,129
Income/(loss) before income taxes	21,571	(137,400)	2,296	(465,465)
Provision for income taxes	10,200	3,200	18,200	23,156
Net income/(loss)	$ 11,371	$ (140,600)	$ (15,904)	$ (488,621)
Net income/(loss) per share:				
Basic	$ 0.02	$ (0.20)	$ (0.02)	$ (0.78)
Diluted	$ 0.02	$ (0.20)	$ (0.02)	$ (0.78)
Shares used in computing per share amounts:				
Basic	643,849	715,733	648,519	623,692
Diluted	647,418	715,733	648,519	623,692

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

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LSI CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended	
	September 28, 2008	September 30, 2007
	(In thousands)	
Operating activities:		
Net loss	$ (15,904)	$ (488,621)
Adjustments:		
Depreciation and amortization	239,945	216,720
Stock-based compensation expense	54,292	55,772
Non-cash restructuring and other items	(3,163)	88,354
Acquired in-process research and development		182,900
Write-down of debt and equity securities	4,500	2,396
Loss/(gain) on sale of property and equipment, including assets held-for-sale	14	(9,513)
Non-cash foreign exchange loss	6,988	3,221
Changes in deferred tax assets and liabilities	4,397	(6,797)
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Accounts receivable, net	5,237	143,998
Inventories	30,884	95,148
Prepaid expenses and other assets	9,192	35,061
Accounts payable	(92,323)	(134,621)
Accrued and other liabilities	(64,194)	658
Net cash provided by operating activities	179,865	184,676
Investing activities:		
Purchases of debt securities available-for-sale	(158,601)	(154,087)
Proceeds from maturities and sales of debt securities available-for-sale	131,719	493,029
Purchases of equity securities	(8,500)	(10,500)
Purchases of property, equipment and software	(95,005)	(76,986)
Proceeds from sale of property and equipment	11,400	13,790
Cash acquired from acquisition of Agere, net of acquisition costs		517,712
Acquisition of other companies, net of cash acquired	(95,137)	(52,079)
Proceeds from sale of Consumer Products Group		22,555
Increase in non-current assets and deposits	(13,300)	
Proceeds received from the resolution of a pre-acquisition income tax contingency	4,821	2,442
Net cash (used in)/provided by investing activities	(222,603)	755,876
Financing activities:		
Issuance of common stock	36,370	28,994
Purchases of common stock under repurchase programs	(229,231)	(549,113)

Net cash used in financing activities	(192,861)	(520,119)
Effect of exchange rate changes on cash and cash equivalents	(1,060)	1,700
(Decrease)/increase in cash and cash equivalents	(236,659)	422,133
Cash and cash equivalents at beginning of year	1,021,569	327,800
Cash and cash equivalents at end of period	$ 784,910	$ 749,933

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

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LSI CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1 BASIS OF PRESENTATION

For financial reporting purposes, LSI Corporation (the Company or LSI) reports on a 13- or 14-week quarter with a year ending December 31. The current quarter ended September 28, 2008. The third quarter of 2007 ended September 30, 2007. The results of operations for the quarter ended September 28, 2008, are not necessarily indicative of the results to be expected for the full year. The first nine months of 2008 and 2007 consisted of approximately 39 weeks each. The third quarter in each of 2008 and 2007 consisted of 13 weeks.

On April 2, 2007, the Company acquired Agere Systems Inc. (Agere) through the merger of Agere and a subsidiary of the Company.

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, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

In management s opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments and restructuring and other items, net, as discussed in Note 3), necessary to state fairly the financial information included herein. While the Company believes that the disclosures are adequate to make the information not misleading, these financial statements should 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, 2007.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157 (FAS 157), Fair Value Measurements. FAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. FAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of FAS 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. In October 2008, the FASB issued FSP 157-3, Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active, which amends FAS 157 by incorporating an example to illustrate key considerations in determining the fair value of a financial asset in an inactive market. FSP 157-3 is effective upon issuance and should be applied to prior periods for which financial statements have not been issued. The adoption of FAS 157 for financial assets and financial liabilities, effective January 1, 2008, had no material impact on the Company s results of operations or financial position. The Company is currently assessing the impact of FAS 157 for nonfinancial assets and nonfinancial liabilities on its results of operations and financial position.

FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company s financial assets and financial liabilities recorded at fair value have been categorized based upon the following three levels of inputs in accordance with FAS 157:

Level 1 Unadjusted, quoted prices in active, accessible markets for identical assets or liabilities. The Company s investments in marketable equity securities and money market funds that are traded in active exchange markets, as well as United States Treasury securities that are highly liquid and are actively traded in over-the-counter markets are classified under level 1.

Level 2 Observable inputs other than level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company s investments in U.S.

government agency securities, commercial paper, corporate and municipal debt securities and asset and mortgage backed securities are traded less frequently than exchange traded securities and are valued using inputs that include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset, such as interest rates and yield curves that are observable at commonly quoted

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intervals. Forward foreign currency contracts traded in the over-the-counter markets are valued using market transactions, or broker quotations. As such, these derivative instruments are classified within level 2.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company utilizes the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

The following table summarizes assets measured at fair value on a recurring basis as of September 28, 2008:

	Fair Value Measurements as of September 28, 2008			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Short-term investments in debt securities and certain cash equivalents	$704,354	$345,769		$1,050,123
Long-term investments in marketable equity securities	$ 1,276			$ 1,276
Rabbi Trust all invested in money market funds	$ 10,107			$ 10,107

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007) (FAS 141(R)), Business Combinations. FAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in an acquiree and the goodwill acquired in an acquisition. FAS 141(R) also establishes disclosure requirements to evaluate the nature and financial effects of a business combination. FAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of FAS 141(R) on its results of operations and financial position.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161 (FAS 161), Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. FAS 161 expands quarterly disclosure requirements in FAS 133 about an entity s derivative instruments and hedging activities. FAS 161 is effective for fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FAS 161 on its results of operations and financial position.

In April 2008, the FASB issued FSP 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standards No. 142 (FAS 142), Goodwill and Other Intangible Assets. FSP 142-3 is intended to improve the consistency among the useful life of a recognized intangible asset under FAS 142, the period of expected cash flows used to measure the fair value of an asset under FAS 141(R), and other guidance under generally accepted accounting principles in the Unites States. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FSP 142-3 on its results of operations and financial position.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162 (FAS 162), The Hierarchy of Generally Accepted Accounting Principles. This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This statement will be effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company is currently evaluating the impact, if any, of the adoption of FAS 162 on its results of operations and financial position.

NOTE 2 STOCK-BASED COMPENSATION

At the Company s annual meeting in May 2008, the stockholders approved amendments to the 2003 Equity Incentive Plan (the 2003 Plan) and the Employee Stock Purchase Plan (the US ESPP). The principal changes to the

2003 Plan were:

Making a total of 45 million shares available for use under the 2003 Plan. Of that amount, 15 million shares were available for grants of restricted stock and restricted stock units;

Allowing non-employee directors to be eligible to participate in the 2003 Plan;

Including stock appreciation rights as a permitted type of award under the 2003 Plan;

Increasing the limits on the size of awards that can be granted under the 2003 Plan to any person in one year from two million to four million shares for stock options and from 0.5 million to one million shares for restricted stock and restricted stock units; and

Allowing incentive stock options to be granted under the 2003 Plan until May 14, 2018.

The Company will no longer award stock options, stock appreciation rights, restricted stock or restricted stock units under any other existing plans.

The principal changes to the US ESPP were:

Making a total of 25 million shares available for purchase under the US ESPP after May 14, 2008;

Consolidating the Company s International Employee Stock Purchase Plan (IESPP) into the US ESPP, which is expected to occur in November 2008; and

Extending the term of the US ESPP through May 14, 2018.

The following table summarizes stock-based compensation expense related to the Company s stock options, employee stock purchase plans (ESPPs, which include the US ESPP and the IESPP) and restricted stock unit awards in the consolidated statements of operations for the three and nine months ended September 28, 2008 and September 30, 2007. Stock-based compensation costs capitalized to inventory and software development for the three and nine months ended September 28, 2008 and September 30, 2007 were not significant.

Stock-Based Compensation Expense Included in:	Three Months Ended September 28, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 28, 2008	Nine Months Ended September 30, 2007
	(In thousands)			
Cost of revenues	$ 2,252	$ 2,824	$ 6,885	$ 7,916
Research and development	6,593	8,916	21,985	22,611
Selling, general and administrative	8,005	10,035	25,422	25,245
Total stock-based compensation expense	$ 16,850	$ 21,775	$ 54,292	$ 55,772

The estimated fair value of the stock-based awards, less expected forfeitures, is amortized over each award s vesting period on a straight-line basis.

Stock Options

The fair value of each option grant is estimated on the date of grant using a reduced form calibrated binominal lattice model (the lattice model). This model requires the use of historical data for employee exercise behavior and the use of the assumptions outlined in the following table:

	Three Months Ended September 28, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 28, 2008	Nine Months Ended September 30, 2007
Weighted average estimated grant date fair value per share	$2.63	$ 2.54	$2.06	$ 3.31
Weighted average assumptions in calculation:				
Expected life (years)	4.38	4.36	4.37	4.35
Risk-free interest rate	3%	4%	3%	5%

Volatility	53%	49%	52%	46%

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the lattice model. The expected life of employee stock options is affected by all of the underlying assumptions and calibration of the Company s model.

The risk-free interest rate assumption is based upon observed interest rates of constant maturity U. S. Treasury securities appropriate for the term of the Company s employee stock options.

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The Company used an equally weighted combination of historical and implied volatilities as of the grant date. The historical volatility is the standard deviation of the daily stock returns for LSI from the date of the initial public offering of its common stock in 1983. For the implied volatilities, the Company uses near-the-money exchange-traded call options, as stock options are call options that are granted at-the-money. The historical and implied volatilities are annualized and equally weighted to determine the volatilities as of the grant date. Management believes that the equally weighted combination of historical and implied volatilities is more representative of future stock price trends than sole use of historical or implied volatilities.

The lattice model assumes that employees exercise behavior is a function of the option s remaining vested life and the extent to which the option is in-the-money. The lattice model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations for all past option grants made by the Company since its initial public offering.

Because stock-based compensation expense recognized is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

A summary of the changes in stock options outstanding during the nine months ended September 28, 2008 is presented below:

	Number of Shares (In thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding at December 31, 2007	100,242	$ 16.12		
Options granted	17,993	5.75		
Options exercised	(4,679)	(5.41)		
Options canceled	(26,035)	(21.78)		
Options outstanding at September 28, 2008	87,521	$ 12.88	4.22	$ 12,251
Options exercisable at September 28, 2008	49,203	$ 17.45	3.02	$ 3,993

As of September 28, 2008, total unrecognized compensation expense related to nonvested stock options, net of estimated forfeitures, was approximately $93.7 million and is expected to be recognized over the next 2.7 years on a weighted average basis. The total intrinsic value of options exercised during the three and nine months ended September 28, 2008 was $1.9 million and $7.2 million, respectively. Cash received from stock option exercises was $6.8 million and $25.3 million for the three and nine months ended September 28, 2008, respectively.

The Company s determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as a number of highly complex and subjective assumptions. The Company uses third-party consultants to assist in developing the assumptions used in, as well as calibrating, the lattice model. The Company is responsible for determining the assumptions used in estimating the fair value of its share-based payment awards.

Employee Stock Purchase Plans

A total of 2.2 million shares and 1.7 million shares related to the ESPPs were issued during the three months ended June 29, 2008 and July 1, 2007, respectively. No shares related to the ESPPs were issued during the three months ended September 28, 2008 and September 30, 2007. For disclosure purposes, the assumptions that went into the calculation of fair value for the May 2008 and May 2007 grants were as follows:

	Three Months Ended	
	June 29, 2008	July 1, 2007
Weighted average estimated grant date fair value per share	$2.13	$ 2.37
Weighted average assumptions in calculation:		
Expected life (years)	0.8	0.8
Risk-free interest rate	2%	5%
Volatility	44%	38%

Restricted Stock Awards

A summary of the changes in restricted stock units outstanding during the nine months ended September 28, 2008 is presented below.

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	Number of Shares (In thousands)
Non-vested shares at December 31, 2007	9,177
Granted	1,736
Vested	(2,337)
Forfeited	(512)
Non-vested shares at September 28, 2008	8,064

As of September 28, 2008, the total unrecognized compensation expense related to restricted stock units, net of estimated forfeitures, was $46.3 million and is expected to be recognized over the next 1.9 years on a weighted average basis. The fair value of shares vested during the three and nine months ended September 28, 2008 was $2.1 million and $12.8 million, respectively.

NOTE 3 RESTRUCTURING AND OTHER ITEMS

The Company recorded charges of $1.6 million and $26.9 million in restructuring of operations and other items, net, for the three and nine months ended September 28, 2008, respectively. The Company recorded charges of $101.2 million and $119.1 million in restructuring of operations and other items, net, for the three and nine months ended September 30, 2007, respectively. For a complete discussion of the 2007 restructuring actions, see Note 2 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

Restructuring and Impairment of Long-Lived Assets

The Company recorded a charge of $1.7 million related to restructuring of operations for the three months ended September 28, 2008, which was recorded in the Semiconductor segment. The Company recorded a charge of $15.0 million related to restructuring of operations for the nine months ended September 28, 2008. Of this charge, $14.7 million and $0.3 million were recorded in the Semiconductor segment and the Storage Systems segment, respectively.

The restructuring of operations charges included $0.9 million and $5.3 million related to the Agere merger for the three and nine months ended September 28, 2008, respectively. See further discussion under Restructuring Actions Associated with the Agere Merger below.

First Quarter of 2008:

A net charge of $1.8 million in restructuring of operations resulted from the following items:

A gain of $2.0 million from the sale of land in Gresham, Oregon, which had a net book value of $0.9 million. Total proceeds from the sale were $2.9 million;

A charge of $5.0 million for lease termination costs, which included $3.1 million for additional lease termination costs in the United States and $1.9 million for changes in previously accrued facility lease exit costs including changes in the time-value of accruals; and

A credit of $1.2 million primarily for severance and termination benefits for employees due to a change in estimates primarily for restructuring actions taken in January 2008.

Second Quarter of 2008:

A charge of $7.1 million in restructuring of operations resulted from the following items:

A charge of $3.4 million for lease termination costs, which included $2.7 million for additional United States lease termination costs including the related write-off of leasehold improvements and $0.7 million in charges for changes in assumptions and changes in the time value of accruals for previously accrued facility lease exit costs; and

A charge of $3.7 million for severance and termination benefits for employees, which included $1.8 million for integrating operations in Asia and $1.9 million for changes in estimates related to various restructuring actions taken since June 2007.

Third Quarter of 2008:

A charge of $0.8 million in restructuring of operations resulted from the following items:

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A credit of $0.6 million for the reversal of a prior accrual offset by changes in previously accrued facility lease exit costs including changes in the time-value of accruals; and

A charge of $1.4 million for severance and termination benefits for employees, which included $0.8 million as the result of a change in severance estimates related to restructuring actions taken in January 2008 and $0.6 million primarily for integrating operations in Asia.

The following table sets forth the Company s restructuring reserves as of September 28, 2008, other than reserves related to restructuring actions associated with the Agere merger, which are included in other accrued liabilities and other non-current liabilities in the consolidated balance sheet, and the activities affecting the accruals since December 31, 2007:

	Balance at December 31, 2007	Restructuring Expense Q1 2008	Utilized During Q1 2008	Balance at March 30, 2008	Restructuring Expense Q2 2008	Utilized During Q2 2008	Balance at June 29, 2008	Restructuring Expense Q3 2008	Utilized During Q3 2008	Balance at September 28, 2008
	(In thousands)									
Write-down of excess assets and other liabilities (a)	$ 225	$ (1,976)	$ 1,834	$ 83	$ 876	$ (876)	$ 83	$ (828)	$ 828	$ 83
Lease terminations (b)	23,318	4,998	(1,961)	26,355	2,494	(4,333)	24,516	252	(3,612)	21,156
Payments to employees for severance (c)	24,817	(1,230)	(12,899)	10,688	3,723	(4,446)	9,965	1,370	(3,626)	7,709
Total	$ 48,360	$ 1,792	$ (13,026)	$ 37,126	$ 7,093	$ (9,655)	$ 34,564	$ 794	$ (6,410)	$ 28,948

(a) The amount utilized in Q1, 2008 includes a gain from the sale of land in Gresham, Oregon.

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

(c) Amounts utilized include \$6.5 million related to stock grants exercised or expired. The majority of the balance remaining for severance is expected to be paid by the end of 2009.

Restructuring Actions Associated with the Agere Merger

In connection with the Agere merger, management approved and initiated plans to restructure the operations of Agere to eliminate certain duplicative activities, reduce cost structure and better align product and operating expenses with existing general economic conditions. Agere restructuring costs were accounted for as liabilities assumed as part of the purchase business combination as of April 2, 2007 in accordance with Emerging Issues Task Force Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. For a complete discussion of the Agere merger, see Note 4 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

Adjustments to the initial restructuring cost estimates made before December 31, 2007 were recorded as an offset to goodwill and to restructuring expense thereafter.

***First Quarter of 2008*:**

A net charge of \$1.5 million in restructuring related to the Agere merger resulted from the following items:

A charge of \$1.1 million for changes in assumptions and the time value of accruals previously recorded for facility lease exit costs;

A charge of \$1.6 million for severance and termination benefits due to a change in severance estimates; and

A gain of \$1.2 million from the sale of assets held for sale in Singapore.

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Second Quarter of 2008:

A net charge of $2.9 million in restructuring related to the Agere merger resulted from the following items:

A charge of $3.0 million for lease termination costs, which included $2.4 million for changes in assumptions resulting from changes in market conditions and $0.6 million for the change in the time value of accruals previously recorded for facility lease exit costs;

A net charge of $0.2 million for severance and termination benefits due to a change in severance estimates; and

A net credit of $0.3 million including a gain of $0.6 million primarily from the sale of assets held for sale in Singapore, a credit of $0.4 million primarily for the reversal of an earlier write-down of held for sale assets which were put back for use and a $0.7 million charge for plant closing costs.

Third Quarter of 2008:

A charge of $0.9 million in restructuring related to the Agere merger resulted from lease termination costs, which included changes in assumptions resulting from changes in market conditions and changes in the time value of accruals previously recorded for facility lease exit costs.

The following table sets forth restructuring reserves related to the Agere merger as of September 28, 2008, which are included in other accrued liabilities and other non-current liabilities in the consolidated balance sheet, and the activities affecting the accruals since December 31, 2007:

	Balance at December 31, 2007	Change in Estimates During Q1 2008	Utilized During Q1 2008	Balance at March 30, 2008	Changes in Estimates During Q2 2008	Utilized During Q2 2008	Balance at June 29, 2008	Changes in Estimates During Q3 2008	Utilized During Q3 2008	Balance at September 28, 2008
	(In thousands)									
Lease terminations (a)	$ 33,439	$ 1,068	$ (3,671)	$ 30,836	$ 3,002	$ (3,647)	$ 30,191	$ 877	$ (2,723)	$ 28,345
Payments to employees for severance (b)	18,926	1,635	(10,581)	9,980	190	(5,102)	5,068	4	(738)	4,334
Stock compensation charges in accordance with FAS 123R (c)	20,860		(7,844)	13,016		(11,290)	1,726			1,726
Write-down of excess assets and other liabilities (d)		(1,163)	1,163		(320)	320		47	(47)	
Total	$ 73,225	$ 1,540	$ (20,933)	$ 53,832	$ 2,872	$ (19,719)	$ 36,985	$ 928	$ (3,508)	$ 34,405

(a)

The amount utilized in Q1, 2008 includes $2.9 million in cash payments and $0.8 million for write-off of leasehold improvements. The balance remaining for real estate lease terminations is expected to be paid during the remaining terms of these contracts, which extend through 2013. There were no write-offs of assets during the second and third quarters of 2008.

(b) Amounts utilized represent cash severance payments to employees. The majority of the balance remaining for severance is expected to be paid by the end of 2008.

(c) Amounts utilized represent stock grants exercised or expired. The balance is expected to be utilized by the end of 2009.

(d) The amount in Q1, 2008 represents a gain on the sale of assets in Singapore. The amount in Q2, 2008 includes a $0.6 million gain on the sale of assets in Singapore.

Assets Held for Sale

Assets held for sale are included as a component of prepaid expenses and other current assets in the consolidated balance sheets as of September 28, 2008 and December 31, 2007. Assets held for sale of $18.4 million as of September 28, 2008 primarily included $16.8 million related to land in Gresham, Oregon and $0.9 million related to land in Colorado. Assets held for sale of $26.1 million as of December 31, 2007 included $17.7 million related to land in Gresham, Oregon, $6.8 million related to semiconductor assembly and test facilities in Singapore and $0.9 million related to land in Colorado.

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Assets classified as held for sale are recorded at the lower of their carrying amount or fair value less cost to sell and are not depreciated. The fair values of impaired equipment and facilities were researched and estimated by management. The Company reassesses the ability to realize the carrying value of these assets at the end of each quarter until the assets are sold or otherwise disposed of, and therefore, additional adjustments may be necessary.

Other Items

The Company recorded a net credit of $0.1 million and a charge of $11.9 million related to other items for the three months and nine months ended September 28, 2008, respectively. The majority of the charge resulted from the settlement of the Litton proceeding referred to in Note 13.

NOTE 4 BUSINESS COMBINATIONS

Acquisition of Hard Disk Drive Semiconductor Business of Infineon

On April 25, 2008, the Company completed the acquisition of the assets of the hard disk drive (HDD) semiconductor business of Infineon Technologies AG (Infineon). The acquisition was intended to enhance the Company s competitive position in the desktop and enterprise HDD space. The acquisition was accounted for under the purchase method of accounting.

In connection with the acquisition, the Company also entered into additional agreements with Infineon, including a supply agreement and a transition service agreement. Under the terms of the supply agreement, Infineon will provide the Company operations handling and wafer supply services for a period of up to six months from the date of acquisition in April 2008. These services were priced separately and at fair market values. Under the terms of the transition services agreement, Infineon will provide the Company engineering services in support of the existing HDD business products for the period from the date of acquisition in April 2008 to December 31, 2009. These services were priced separately and at fair market values.

The table below provides information about this acquisition:

Entity Name or Type of Technology; Segment Included in; Description of Acquired Business	Acquisition Date	Total Purchase Price	Type of Consideration	Fair Value of Other Assets Acquired	Goodwill	Amortizable Intangible Assets
				(Dollars in millions)		
HDD semiconductor business of Infineon; Semiconductor segment; Silicon solutions for hard disk drive makers	April 25, 2008	$95.1	cash	$ 10.3	$6.6	$ 78.2

The following table sets forth the components of the identifiable intangible assets associated with this acquisition, which are being amortized over the estimated usage periods:

	Fair Value (In millions)	Weighted Average Useful Life (in years)
Current technology	$ 46.5	4
Customer base	31.7	5
Total acquired identifiable intangible assets	$ 78.2	

Pro forma financial information has not been presented because the effect of this acquisition on the Company s results of operations was not material.

Agere Merger Pro Forma Results

On April 2, 2007, the Company acquired Agere. The following pro forma summary is provided for illustrative purposes only and is not necessarily indicative of the consolidated results of operations for future periods or results that actually would have been realized had the Company and Agere been a consolidated entity during the period presented. The summary combines the results of operations as if Agere had been acquired as of the beginning of the period presented.

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The summary includes the impact of certain adjustments such as amortization of intangibles, stock compensation charges and interest expense related to Agere s convertible notes that the Company guaranteed. Additionally, acquired in-process research and development associated with the Agere acquisition has been excluded from the period presented. Pro forma amounts presented below are in thousands except per share data.

	Nine Months Ended September 30, 2007
Revenues	$ 2,197,613
Net loss	$ (309,374)
Basic loss per share	$ (0.41)
Diluted loss per share	$ (0.41)

NOTE 5 BENEFIT OBLIGATIONS

The Company has pension plans covering substantially all former Agere U. S. employees, excluding management employees hired after June 30, 2003. Retirement benefits are offered under a defined benefit plan and are based on either an adjusted career average pay or dollar per month formula or on a cash balance plan. The cash balance plan provides for annual company contributions based on a participant s age and compensation and interest on existing balances and covers employees of certain companies acquired by Agere since 1996 and management employees hired after January 1, 1999 and before July 1, 2003. The Company also has postretirement benefit plans that include healthcare benefits and life insurance coverage for former Agere employees. Participants in the cash balance plan and management employees hired after June 30, 2003 are not entitled to company paid benefits under the postretirement benefit plans. The Company also has pension plans covering certain international employees.

The following table sets forth the components of the net periodic benefit credit for the three and nine months ended September 28, 2008 and September 30, 2007:

	Three Months Ended			
	September 28, 2008		September 30, 2007	
	Pension Benefits	Post-retirement Benefits	Pension Benefits	Post-retirement Benefits
	(In thousands)			
Service cost	$ 1,298	$ 25	$ 1,867	$ 41
Interest cost	18,947	745	18,395	932
Expected return on plan assets	(20,701)	(1,258)	(21,026)	(1,235)
Amortization of prior service cost	4			
Net actuarial gain recognized		(30)		
Total benefit credit	$ (452)	$ (518)	$ (764)	$ (262)

	Nine Months Ended			
	September 28, 2008		September 30, 2007	
	Pension Benefits	Post-retirement Benefits	Pension Benefits	Post-retirement Benefits
	(In thousands)			
Service cost	$ 4,201	$ 77	$ 3,734	$ 82
Interest cost	56,084	2,278	36,791	1,863
Expected return on plan assets	(61,865)	(3,775)	(41,885)	(2,429)
Amortization of prior service cost	12			

Net actuarial gain recognized		(1)		(89)				
Total benefit credit	$	(1,569)	$	(1,509)	$	(1,360)	$	(484)

During the nine months ended September 28, 2008, the Company contributed $8.8 million to its pension plans and $11.9 million to its post-retirement benefit plans. The Company expects to contribute an additional $1.7 million and $3.6 million to its pension plans and post-retirement benefit plans, respectively, for the remainder of 2008.

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NOTE 6 INTANGIBLE ASSETS AND GOODWILL

Intangible Assets

As of September 28, 2008 and December 31, 2007, intangible assets by reportable segment were comprised of the following:

	September 28, 2008		December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Semiconductor:				
Current technology	$ 894,808	$ (394,702)	$ 848,656	$ (298,525)
Trademarks	26,657	(26,236)	26,730	(26,272)
Customer base	399,508	(65,782)	367,808	(20,761)
Non-compete agreements	1,949	(1,639)	1,949	(1,165)
Existing purchase orders	200	(200)	200	(200)
Supply agreement	100	(100)	100	(100)
Patent licensing	313,800	(54,367)	313,800	(27,183)
Order backlog	41,300	(41,300)	41,300	(41,300)
Workforce	3,567	(1,108)	3,567	(661)
Trade names	2,248	(375)	2,248	(94)
Subtotal	1,684,137	(585,809)	1,606,358	(416,261)
Storage Systems:				
Current technology	164,339	(134,668)	164,339	(130,361)
Trademarks	7,150	(7,150)	7,150	(7,149)
Customer base	5,010	(5,010)	5,010	(5,010)
Non-compete agreements	1,600	(1,600)	1,600	(1,156)
Supply agreement	8,147	(8,147)	8,147	(8,147)
Trade names	800	(209)	800	(124)
Subtotal	187,046	(156,784)	187,046	(151,947)
Total intangible assets	$ 1,871,183	$ (742,593)	$ 1,793,404	$ (568,208)

On April 25, 2008, the Company completed the acquisition of Infineon s HDD semiconductor business.

The following table sets forth amortization expense and weighted average lives of intangible assets:

	Weighted Average Lives	Nine Months Ended	
		September 28, 2008	September 30, 2007
	(In months)	(In thousands)	
Current technology	57	$ 100,833	$ 65,392
Trademarks	83	37	839
Customer base	45	45,020	13,809
Non-compete agreements	27	918	1,238

Supply agreement	32		775
Patent licensing	36	27,183	18,259
Order backlog	2		53,000
Workforce	72	447	447
Trade names	75	366	86
Total	50	$ 174,804	$ 153,845

The estimated future amortization expense related to intangible assets as of September 28, 2008 was as follows:

	Amount (In thousands)
Fiscal Year:	
2008 (September 29 through December 31, 2008)	$ 60,279
2009	234,926
2010	191,666
2011	149,914
2012 and thereafter	491,805
Total	$ 1,128,590

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Goodwill

The following table sets forth changes in the carrying amount of goodwill for the nine months ended September 28, 2008:

	Semiconductor Segment	Storage Systems Segment (In thousands)	Total
Balance as of December 31, 2007	$ 323,927	$ 175,624	$ 499,551
Goodwill acquired during the year *	6,624		6,624
Goodwill acquired in a prior year for a pre-acquisition income tax contingency **	31,342		31,342
Balance as of September 28, 2008	$ 361,893	$ 175,624	$ 537,517

* During the nine months ended September 28, 2008, the Company recorded $6.6 million of goodwill in connection with the acquisition of Infineon s HDD semiconductor business.

** During the nine months ended September 28, 2008, the Company recorded $37.1 million of goodwill primarily relating to a re-measurement of uncertain tax positions based on new information received in the third quarter of 2008 offset by

$5.8 million of
income tax
refunds.

NOTE 7 DERIVATIVE INSTRUMENTS

The Company has foreign subsidiaries that operate and sell the Company s products in various global markets. As a result, the Company is exposed to changes in foreign currency exchange rates. The Company utilizes various hedge instruments, primarily forward contracts, to manage its exposure associated with net asset and liability positions denominated in non-functional currencies and forecasted foreign currency transactions to reduce the volatility of earnings and cash flows. The Company does not hold derivative financial instruments for speculative or trading purposes.

The Company enters into forward contracts that are designated as foreign currency cash flow hedges of forecasted payments denominated in currencies other than U.S. dollars. Changes in the fair value of the forward contracts attributable to changes in time value are excluded from the assessment of effectiveness and are recognized in interest income and other, net. The effective portion of the forward contracts gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion, if any, of the gain or loss is reported in earnings immediately. As of September 28, 2008, the Company held forward contracts designated as foreign currency cash flow hedges of forecasted Euro, Pound Sterling and Indian Rupee payment transactions that were set to expire from one to eleven months. For the three and nine months ended September 28, 2008, the changes in time value of these forward contracts were not significant. The unrealized gains, net of incomes taxes, included in accumulated other comprehensive income as of September 28, 2008, which will be reclassified into earnings within the next twelve months, were $0.1 million. The Company did not record any gains or losses due to hedge ineffectiveness for the three and nine months ended September 28, 2008. There were no such hedges outstanding as of December 31, 2007.

NOTE 8 OTHER BALANCE SHEET DETAILS

	September 28, 2008	**December 31, 2007**
	(In thousands)	
Cash and cash equivalents:		
Cash in financial institutions	$ 65,751	$ 117,464
Cash equivalents	719,159	904,105
Total cash and cash equivalents	$ 784,910	$ 1,021,569
Available-for-sale debt securities: *		
Asset-backed and mortgage-backed securities	$ 206,523	$ 207,290
U.S. government and agency securities	163,226	121,350
Corporate and municipal debt securities	19,268	47,388
Total short-term investments	$ 389,017	$ 376,028
Inventories:		
Raw materials	$ 31,560	$ 30,023
Work-in-process	63,696	95,262
Finished goods	114,702	115,557
Total inventories	$ 209,958	$ 240,842

	Maturity	Interest Rate	Conversion Price	September 28, 2008	December 31, 2007
			(In thousands)		
Long-term debt:					
2003 Convertible Subordinated Notes	2010	4.00%	$ 13.4200	$ 350,000	$ 350,000
2002 Convertible Subordinated Notes **	2009	6.50%	$ 15.3125	361,645	361,660
Accrued debt premium				8,589	8,589
				720,234	720,249
Amortization of accrued debt premium				(4,639)	(2,282)
Total long-term debt				$ 715,595	$ 717,967

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* During the three and nine months ended September 28, 2008, the Company recognized impairment charges of $1.7 million and $3.8 million for certain available-for-sale debt securities, after determining that the decline in their fair value was other than temporary.

** During the nine months ended September 28, 2008, $15,000 of the principal amount of these notes was converted into 977 shares of LSI s common stock at the conversion price of $15.3125 per share.

See Note 14 regarding subsequent events.

NOTE 9 RECONCILIATION OF BASIC AND DILUTED INCOME/(LOSS) PER SHARE

The following table sets forth a reconciliation of the numerators and denominators used in the computation of basic and diluted per share amounts:

	Three Months Ended					
	September 28, 2008			September 30, 2007		
	Income*	Shares+	Per-Share Amount	Loss*	Shares+	Per-Share Amount
	(In thousands except per share amounts)					

Basic income/(loss) per share:						
Net income/(loss) available to common stockholders	$11,371	643,849	$0.02	$(140,600)	715,733	$(0.20)
Stock options, employee stock purchase rights and restricted stock unit awards		3,569			&nb	