CONEXANT SYSTEMS INC
Form 10-Q
August 15, 2011

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

FORM 10-Q

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

For the Quarterly Period Ended July 1, 2011

OR

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

Commission file number: 000-24923

CONEXANT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

4000 MacArthur Boulevard
Newport Beach, California 92660-3095
(Address of principal executive offices) (Zip code)
(949) 483-4600
(Registrant s telephone number, including area code)

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

Explanatory Note: While the registrant is not subject to the filing requirements of Section 13 or 15(d) of the Exchange Act, it has filed all reports pursuant to Section 13 or 15(d) of the Exchange Act during the preceding 12 months.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (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 August 15, 2011, there were 100,000,000 shares of the registrant s common stock outstanding.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes 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, that are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words, such as may, will, could, project, believe, an expect, estimate, continue, potential, plan, forecasts, and the like, the negatives of such expressions, or the us future tense.. Examples of forward-looking statements include, but are not limited to, statements concerning:

our expectations regarding the market share of our products, growth in the markets we serve and our market opportunities;

our expectations regarding the price of our products, and product competition;

our expectations regarding the continued and future demand for our products;

our expectations regarding the declines in our legacy products;

our plans and expectations regarding the transition of our semiconductor products to smaller line width geometries;

our expectation that we will be able to sustain the recoverability of our goodwill, intangible and tangible long-term assets;

our product development plans;

our expectation that our largest customers will continue to account for a substantial portion of our revenue;

our expectations regarding our contractual obligations and commitments;

our expectation that we will be able to protect our products and services with proprietary technology and intellectual property protection;

our expectation that we will be able to meet our lease obligations (and other financial commitments);

our expectations, subject to the qualifications expressed, regarding the sufficiency of our existing sources of liquidity, together with cash expected to be generated from operations, to fund our operations, research and development, anticipated capital expenditures, and working capital for at least the next twelve months;

our expectation that we will be able to continue to rely on third party manufacturers to manufacture, assemble and test our products to meet our customers demands; and

our expectations that we will be able to use our net operating losses and other tax attributes to offset future taxable income.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. You are urged to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including, but not limited to, those made under the heading Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q, those made under the heading Risk Factors in our Annual Report on Form 10-K, for the fiscal year ended October 1, 2010 which was filed with the SEC on November 9, 2010, and those made in our other filings with the Securities and Exchange

Commission (the SEC). Please consider our forward-looking statements in light of those risks as you read this Quarterly Report on Form 10-Q. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. We do not intend, and undertake no obligation, to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events, except as required by law.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands, except for par value)

	Successor July 1, 2011	Predecessor October 1, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 50,408	$ 54,466
Marketable securities		20,059
Receivables, net of allowance of $181 and $368 at July 1, 2011 and October 1, 2010, respectively	24,220	31,463
Inventories	19,667	8,747
Other current assets	8,750	14,690
Assets held for sale		13,059
Total current assets	103,045	142,484
Property, plant and equipment, net of accumulated depreciation of $820 and $30,050 at July 1, 2011 and October 1, 2010, respectively	11,634	6,080
Goodwill	222,661	109,908
Intangible assets	113,774	4,308
Other assets	23,778	43,064
Total assets	$ 474,892	$ 305,844
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt	$	$ 10,978
Accounts payable	11,377	12,516
Accrued compensation and benefits	8,701	7,682
Other current liabilities	29,373	31,836
Total current liabilities	49,451	63,012
Long-term debt	194,249	173,543
Other liabilities	69,100	57,197
Total liabilities	312,800	293,752
Commitments and contingencies (Note 6)		
Shareholders equity:		
Preferred and junior preferred stock: zero and 20,000 shares authorized at July 1, 2011 and October 1, 2010, respectively		
Common stock, $0.01 par value: 200,000 shares authorized; 100,000 and 81,273 shares issued and outstanding at July 1, 2011 and October 1, 2010, respectively	1,000	813
Additional paid-in capital	202,865	4,919,582
Accumulated deficit	(41,838)	(4,909,509)

Accumulated other comprehensive income	65	1,206
Total shareholders equity	162,092	12,092
Total liabilities and shareholders equity	$ 474,892	$ 305,844

See accompanying notes to unaudited consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Successor	Predecessor	
	Period from April 20, 2011 through July 1, 2011	Period from April 2, 2011 through April 19, 2011	Fiscal Quarter Ended July 2, 2010
Net revenues	$ 37,009	$ 3,872	$ 60,730
Cost of goods sold	33,327	2,233	23,645
Gross margin	3,682	1,639	37,085
Operating expenses:			
Research and development	11,646	2,822	14,569
Selling, general and administrative	7,626	1,867	11,647
Amortization of intangible assets	4,826	53	285
Special charges	12,580	5,660	723
Total operating expenses	36,678	10,402	27,224
Operating (loss) income	(32,996)	(8,763)	9,861
Interest expense	3,115	1,054	7,159
Other expense, net	3,812	3,778	9,248
Loss from continuing operations before income taxes and loss on equity method investments	(39,923)	(13,595)	(6,546)
Income tax provision (benefit)	229	(30)	322
Loss from continuing operations before loss on equity method investments	(40,152)	(13,565)	(6,868)
Loss on equity method investments	(6)		(130)
Loss from continuing operations	(40,158)	(13,565)	(6,998)
Loss from discontinued operations, net of tax	(1,680)	(72)	(455)
Net loss	$ (41,838)	$ (13,637)	$ (7,453)
Loss per share from continuing operations basic and diluted		$ (0.16)	$ (0.09)
Loss per share from discontinued operations basic and diluted		$ (0.01)	$ 0.00
Loss per share basic and diluted		$ (0.17)	$ (0.09)

Shares used in basic and diluted per-share computations	82,223	81,200

See accompanying notes to unaudited consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Successor	Predecessor	
	Period from April 20, 2011 through July 1, 2011	Period from October 2, 2010 through April 19, 2011	Nine Fiscal Months Ended July 2, 2010
Net revenues	$ 37,009	$ 93,111	$ 184,411
Cost of goods sold	33,327	39,849	71,936
Gross margin	3,682	53,262	112,475
Operating expenses:			
Research and development	11,646	30,932	41,914
Selling, general and administrative	7,626	24,155	36,730
Amortization of intangible assets	4,826	621	965
Gain on sale of intellectual property		(1,249)	
Special charges	12,580	20,890	859
Total operating expenses	36,678	75,349	80,468
Operating (loss) income	(32,996)	(22,087)	32,007
Interest expense	3,115	12,278	24,437
Other expense (income), net	3,812	8,423	(5,711)
(Loss) income from continuing operations before income taxes and (loss) income on equity method investments	(39,923)	(42,788)	13,281
Income tax provision	229	380	423
(Loss) income from continuing operations before (loss) income on equity method investments	(40,152)	(43,168)	12,858
(Loss) income on equity method investments	(6)	1,495	(375)
(Loss) income from continuing operations	(40,158)	(41,673)	12,483
Loss from discontinued operations, net of tax	(1,680)	(461)	(723)
Net (loss) income	$ (41,838)	$ (42,134)	$ 11,760
(Loss) income per share from continuing operations basic and diluted		$ (0.51)	$ 0.18
		$ 0.00	$ (0.01)

Loss per share from discontinued operations basic and diluted		
(Loss) income per share basic and diluted	$ (0.51)	$ 0.17
Shares used in basic per-share computations	81,996	70,120
Shares used in diluted per-share computations	81,996	70,964

See accompanying notes to unaudited consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Successor	Predecessor	
	Period from April 20, 2011 through July 1, 2011	Period from October 2, 2010 through April 19, 2011	Nine Fiscal Months Ended July 2, 2010
Cash flows from operating activities:			
Net (loss) income	$ (41,838)	$ (42,134)	$ 11,760
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation	766	1,425	2,646
Amortization of intangible assets	4,826	621	965
Reversal of provision for bad debts, net			(34)
Charges for inventory provisions, net	1,270	449	83
Provision for loss on inventory purchase commitments	949		
Release of inventory step-up upon shipment	16,285		
Amortization of debt (premium) discount	(876)	419	7,785
Deferred income taxes	(13)	19	54
Stock-based compensation		4,057	5,025
Decrease (increase) in fair value of derivative instruments	3,757	9,469	(11,353)
Losses (gains) on equity method investments	7	(1,495)	1,229
Loss on termination of swap			1,728
Loss on extinguishment of debt			18,581
Net gain on sale of equity securities	(5)	(1,393)	(12,911)
Gain on sale of intellectual property		(1,249)	
Other items, net	16	(276)	(1,386)
Changes in assets and liabilities:			
Receivables	1,310	6,071	(6,082)
Inventories	3,351	(6,291)	(181)
Accounts payable	(2,733)	1,576	(9,405)
Accrued expenses and other current liabilities	5,829	(5,269)	(327)
Other, net	3,751	2,764	(1,897)
Net cash (used in) provided by operating activities	(3,348)	(31,237)	6,280
Cash flows from investing activities:			
Purchases of property, plant and equipment	(631)	(729)	(836)
Acquisition of Predecessor	(203,865)		
Proceeds from sale of real estate, net of closing costs of $439		21,087	
Proceeds from sale of property, plant and equipment	15	52	741
Payments for acquisitions			(625)

Proceeds from sales of marketable securities		20,000	88,634
Purchases of marketable securities			(95,334)
Proceeds from sales of equity securities	23	802	
Release of restricted cash	(2)	533	8,500
Proceeds from sale of intellectual property		1,249	
Net cash (used in) provided by investing activities	(204,460)	42,994	1,080
Cash flows from financing activities:			
Net repayments of short-term debt, including debt costs of $60 and $483		(11,278)	(29,136)
Extinguishment of long-term debt, including costs of $3,445			(288,747)
Proceeds from common stock offerings, net of expenses of $4,881			62,510
Proceeds from issuance of senior secured notes, net of expenses of $4,918			168,442
Proceeds from issuance of common stock under employee stock plans		95	19
Repurchase of shares upon exercise of employee stock awards		(689)	(35)
Advances (to) from Gold Holdings, Inc.	(6,443)	6,443	
Equity contributions	203,865		
Net cash provided by (used in) financing activities	197,422	(5,429)	(86,947)
Net increase in cash and cash equivalents	(10,386)	6,328	(79,587)
Cash and cash equivalents at beginning of period	60,794	54,466	125,385
Cash and cash equivalents at end of period	$ 50,408	$ 60,794	$ 45,798

See accompanying notes to unaudited consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME (SUCCESSOR)
(in thousands)

	Common Stock		Additional		Accumulated Other Comprehensive Income	Total
			Paid-In	Accumulated	(net of	Shareholders
	Shares	Amount	Capital	Deficit	tax)	Equity
Balance at April 20, 2011		$	$	$	$	$
Net loss				(41,838)		(41,838)
Currency translation adjustment					65	65
Comprehensive loss						(41,773)
Equity contribution	100,000	1,000	202,865			203,865
Balance at July 1, 2011	100,000	$ 1,000	$ 202,865	$ (41,838)	$ 65	$ 162,092

UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIT) AND COMPREHENSIVE INCOME (PREDECESSOR)
(in thousands)

	Common Stock		Additional		Accumulated Other Comprehensive Income	Total Shareholders
			Paid-In	Accumulated	(net of	Equity
	Shares	Amount	Capital	Deficit	tax)	(Deficit)
Balance at October 1, 2010	81,273	$ 813	$ 4,919,582	$ (4,909,509)	$ 1,206	$ 12,092
Net loss				(42,134)		(42,134)
Currency translation adjustment					526	526
Change in unrealized gain on available-for-sale securities					(13)	(13)
Comprehensive loss						(41,621)
Common stock issued related to employee stock plans	950	10	85			95
Employee stock-based compensation expense			3,368			3,368
Balance at April 19, 2011	82,223	$ 823	$ 4,923,035	$ (4,951,643)	$ 1,719	$ (26,066)

See accompanying notes to unaudited consolidated financial statements

CONEXANT SYSTEMS, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

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

Merger with Conexant Holdings, Inc.

On April 19, 2011, the Company completed a merger with Gold Acquisition Corp., a Delaware corporation (Merger Sub) and a wholly owned subsidiary of Gold Holdings, Inc., a Delaware corporation, subsequently renamed Conexant Holdings, Inc. (Conexant Holdings). Pursuant to the Agreement and Plan of Merger dated as of February 20, 2011, by and among the Company, Gold Holdings, Inc. and Merger Sub (the   Merger Agreement), Merger Sub was merged with and into the Company, with the Company surviving as a wholly owned subsidiary of Conexant Holdings (the   Merger). In connection with the Merger, shares of the Company s common stock ceased to be traded on the NASDAQ Stock Market after close of market on April 19, 2011.

At the consummation of the Merger, each share of common stock, par value $0.01 per share, of the Company (the   Company Common Stock) issued and outstanding immediately prior to the effective time of the Merger (the   Effective Time) was converted into the right to receive $2.40 in cash, without interest and subject to any applicable withholding tax (the   Gold Merger Consideration). Stock options to acquire Company Common Stock that were outstanding and unexercised immediately prior to the Effective Time were cancelled and converted into the right to receive, with respect to each such option, an amount of cash equal to the excess, if any, of the Gold Merger Consideration over the exercise price per share under the option for each share subject to such option. Any option with an exercise price greater than or equal to the Gold Merger Consideration was cancelled without consideration. Each restricted stock unit (RSU) that, as of immediately prior to the Effective Time, was outstanding and held by a non-employee director of the Company or a management-level employee of the Company at the rank of senior vice president or above was cancelled and converted into the right to receive an amount of cash equal to the Gold Merger Consideration. All remaining RSUs were cancelled with the Holders of such RSUs being entitled to receive with respect to each RSU on the date that the RSU would have otherwise vested had the Effective Time not occurred an amount of cash equal to the Gold Merger Consideration; provided that such payment will only be required if (a) the employee continues to be employed continuously by the surviving corporation through and including the original vesting date of such RSUs and (b) the employee has not otherwise been issued or granted any incentive compensation following the Effective Time (but prior to such original vesting date) that the surviving corporation s board of directors has determined in good faith in its sole discretion to be an appropriate replacement for such RSUs.

The aggregate consideration for all equity securities including cancelled and converted stock options and RSUs of the Company was $203.8 million. An additional $0.1 million consideration was paid concurrent with the Merger to satisfy an existing bank line of credit. The Merger was funded with the proceeds of equity contributions from Golden Gate Capital and affiliated entities in the amount of $203.9 million.

Termination of Merger Agreement with Standard Microsystems Corporation

On February 23, 2011, the Company terminated its previously announced Agreement and Plan of Merger, dated January 9, 2011 (the   SMSC Agreement), with Standard Microsystems Corporation, a Delaware corporation (SMSC), and Comet Acquisition Corp., a Delaware corporation and wholly owned subsidiary of SMSC. Pursuant to the terms of the SMSC Agreement, the Company paid a termination fee of $7.7 million to SMSC.

Interim Reporting The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated.

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s Annual Report on Form 10-K for the fiscal year ended October 1, 2010. The financial information presented in the accompanying statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the periods indicated. All such adjustments are of a normal recurring nature. The year-end balance sheet data was derived from the audited consolidated financial statements.

Fiscal Periods The Company s fiscal year is the 52- or 53-week period ending on the Friday closest to September 30. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal 2011 consists of, and fiscal 2010 consisted of, 52 weeks.

For the purposes of presentation and disclosure, all references to Predecessor relate to Conexant Systems, Inc. for periods prior to the Merger. All references to Successor relate to Conexant Systems, Inc. merged with Merger Sub for periods subsequent to the Merger. References to we , us , our , Conexant and the Company relate to the Predecess the periods prior to the Merger and to the Successor for periods subsequent to the Merger.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States (US GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Among the significant estimates affecting the consolidated financial statements are those related to fair-value measurements applied to tangible and intangible assets acquired and liabilities assumed in connection with the Merger, revenue recognition, allowance for doubtful accounts, reserves related to inventories and sales returns, long-lived assets (including goodwill and intangible assets), deferred income taxes, valuation of warrants, stock-based compensation and restructuring charges. On an ongoing basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

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

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

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

Restricted Cash The Company has outstanding letters of credit collateralized by restricted cash aggregating $5.1 million and $5.6 million as of July 1, 2011 and October 1, 2010, respectively, to secure various long-term operating leases and the Company s self-insured worker s compensation plan. The restricted cash associated with these letters of credit is classified as other long-term assets on the consolidated balance sheets.

Inventories On a quarterly basis, the Company assesses the net realizable value of its inventories. When the estimated average selling prices, less cost to sell its inventory, falls below its inventory cost, the Company adjusts its inventory to its current estimated market value. Lower of cost or market adjustments may be required based upon actual average selling prices and changes to the Company s current estimates, which could impact the Company s gross margin percentage. The Company recorded a lower of cost or market adjustment of $0.2 million in the period from April 20, 2011 through July 1, 2011 reflecting a price decrease on certain inventory. There were no lower of cost or market adjustments in any other period presented.

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

Accounting for Convertible Debt The Company has adopted the accounting guidance for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). This guidance requires the issuer to separately account for the liability and equity components of convertible debt instruments in a manner that reflects the issuer s hypothetical nonconvertible debt borrowing rate. The guidance resulted in the Company recognizing higher interest expense in the statement of operations due to amortization of the discount that results from separating the liability and equity components. The accounting guidance applies to our 4.00% convertible subordinated notes (convertible notes) issued in 2006. The Company redeemed the remaining $11.2 million of convertible notes on March 1, 2011.

Derivative Financial Instruments The Company s derivative financial instruments as of July 1, 2011 consisted of the Company s warrant to purchase 6.1 million shares of Mindspeed Technologies, Inc. (Mindspeed) common stock. Gains and losses on the warrant are included in other expense (income), net.

Supplemental Cash Flow Information There was no cash paid for interest in the period from April 20, 2011 through July 1, 2011. Cash paid for interest for the period from October 2, 2010 through April 19, 2011 and the nine fiscal months ended July 2, 2010 was $10.2 million and $7.0 million, respectively. Cash paid for income taxes for the period from April 20, 2011 to July 1, 2011 was $0.2 million. Cash paid for income taxes for the period from October 2, 2010 to April 19, 2011 and the nine fiscal months ended July 2, 2010 was $0.4 million and $2.2 million, respectively.

Accumulated Other Comprehensive Income Accumulated Other comprehensive income includes foreign currency translation adjustments and unrealized gains on marketable securities. The components of accumulated other comprehensive income are as follows (in thousands):

	Successor July 1, 2011	Predecessor October 1, 2010
Foreign currency translation adjustments	$ 65	$ 1,193
Unrealized gains on available-for-sale securities		13
Accumulated other comprehensive income	$ 65	$ 1,206

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

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

		Predecessor		
	Period from April 2, 2011 through April 19, 2011	Fiscal Quarter Ended July 2, 2010	Period from October 2, 2010 through April 19, 2011	Nine Fiscal Months Ended July 2, 2010
Employee stock options and restricted stock units	2,044	1,139	1,268	
		1,046	172	3,550

4.00% convertible subordinated notes due March 2026	2,044	2,185	1,440	3,550

The following potentially dilutive securities have been included in the diluted net (loss) income per share calculations (in thousands):

	Predecessor			
	Period from April 2, 2011 through April 19, 2011	Fiscal Quarter Ended July 2, 2010	Period from October 2, 2010 through April 19, 2011	Nine Fiscal Months Ended July 2, 2010
Weighted average shares for basic net (loss) income per share	82,223	81,200	81,996	70,120
Employee stock options and restricted stock units				844
Weighted average shares for diluted (loss) income per share	82,223	81,200	81,996	70,964

Impairment of Assets The Company periodically reviews long-lived assets and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. If an asset is considered to be impaired, the impairment loss is recognized immediately and is considered to be the amount by which the carrying amount of the asset exceeds its fair value.

The Company did not conduct an impairment review as of July 1, 2011, due to the relatively short time period between the Merger consummation date and the period end date. The Company has not recognized any impairment loss for any long-lived or intangible asset as of July 1, 2011.

Goodwill Goodwill is tested annually during the fourth fiscal quarter and, if necessary, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. During the third fiscal quarter of 2011, based on current business forecasts, the Company determined there were no indicators of impairment and therefore no interim goodwill impairment analysis was considered necessary for this period.

Recently Issued Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board, (FASB), issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on the Company s financial statements.

In May 2011, the FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on the Company s financial statements.

In December 2010, the FASB issued an update to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This accounting guidance will be effective for financial statements issued for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years. Early adoption is not permitted. The Company is currently evaluating the impact of this guidance on its financial position and results of operations.

2. Merger with Conexant Holdings, Inc.

The Merger is being accounted for as a business combination using the acquisition method of accounting, whereby the purchase price was preliminarily allocated to tangible and intangible assets acquired and liabilities assumed, based on their estimated fair market values. Fair-value measurements have been applied based on assumptions that market participants would use in the pricing of the asset or liability. The following table summarizes the fair value assigned to the assets acquired and liabilities assumed as of April 19, 2011, the acquisition date (in thousands):

Total merger consideration:	
Cash paid to shareholders	$ 197,335
Cash paid to holders of cancelled stock options and RSUs upon change of control	6,427
Bank line of credit assumed and repaid	102
Total merger consideration	203,864
Fair value of assets acquired and liabilities assumed:	
Cash and cash equivalents	60,794

Accounts receivable	25,530
Inventories	40,573
Other current assets	8,582
Property and equipment	11,866
Intangible assets	118,600
Other assets	28,366
Accounts payable	(14,215)
Deferred income tax liabilities, net	(21,655)
Other liabilities current and long term	(82,113)
Long-term debt	(195,125)
Net liabilities assumed	(18,797)
Excess purchase price atttributed to goodwill acquired	$ 222,661

The preliminary fair value of the acquired intangible assets was determined using the following income valuation approaches. In estimating the preliminary fair value of the acquired intangible assets, the Company utilized the valuation methodology determined to be most appropriate for the individual intangible asset being valued as described below. The acquired intangible assets include the following (in thousands):

		Estimated	Remaining Useful Life (yrs)
	Valuation Method	**Fair Value**	**(1)**
Customer relationships	Multi-Period Excess Earnings (2)	$ 50,300	7.0
In-process research and development (IPR&D)	Multi-Period Excess Earnings (2)	46,000	
Trade name and trademarks	Relief-from-Royalty (3)	15,100	
Backlog	Multi-Period Excess Earnings (2)	4,200	0.5
Patents	Relief-from-Royalty (3)	2,900	8.3
Non-compete agreement	Comparative Business Valuation (4)	100	1.0
Total purchased intangible assets		$ 118,600	

(1) Determination of the estimated useful lives of the individual categories of purchased intangible assets was based on the nature of the applicable intangible asset and the expected future cash flows to be derived from the intangible asset. Amortization of intangible assets with definite lives are recognized over the shorter of the respective lives of the agreement or the period of time the assets are expected to contribute to future cash flows.

(2) The Multi-Period Excess Earnings method is a discounted cash flow method within the income approach which estimates a purchased intangible asset value based on the present value of the projected excess net cash flows derived from the operations of the business. The value attributed to customer relationship and backlog intangible assets was based on projected net cash inflows from existing contracts or relationships. The value attributed to IPR&D intangible assets was based on projected net cash inflows from estimates for projects under development.

(3) The Relief-from-Royalty method is a discounted cash flow method within the income approach which calculates the value attributable to owning the trade name, trademarks and patents as opposed to paying a third-party for their use.

(4) The Comparative Business Valuation method is a discounted cash flow method within the income approach where the value of the intangible asset is estimated based on the difference in value with and without the non-compete agreement in place.

Some of the more significant estimates and assumptions inherent in the estimate of the fair value of the identifiable purchased intangible assets include all assumptions associated with forecasting cash flows and profitability. The primary assumptions used for the determination of the preliminary fair value of the purchased intangible assets were generally based upon the present value of anticipated cash flows discounted at risk adjusted rates of approximately 15-16.5%, based on the Company s weighted average cost of capital. Estimated years of projected earnings generally follow the range of estimated remaining useful lives for each intangible asset class.

As of April 19, 2011, the purchase price allocation is preliminary and could change materially in subsequent periods. Any subsequent changes to the purchase price allocation that result in material changes to the Company s consolidated financial results will be adjusted retrospectively. Based on the preliminary purchase price allocation none of the excess purchase price attributed to goodwill is expected to be deductible for tax purposes.

At the time of the Merger, the Company believed its market position and future growth potential for its semiconductor system solutions business were the primary factors that contributed to a total purchase price that resulted in the recognition of goodwill.

Transaction Costs:

In the period from April 2, 2011 through April 19, 2011 and October 2, 2010 through April 19, 2011 the Company recorded $5.3 million and $16.9 million, respectively, in Merger related transaction costs for accounting, investment banking, legal and other costs including a $7.7 million termination fee to SMSC upon termination of the SMSC Agreement. In the period from April 20, 2011 through July 1, 2011 the Company paid $0.4 million in transaction costs.

Pro Forma Financial Information:

The following unaudited pro forma results of operations assume that the Merger had occurred on October 2, 2010 for the nine fiscal months ended July 1, 2011 and October 3, 2009 for the nine fiscal months ended July 2, 2010 after giving effect to acquisition accounting adjustments relating to depreciation and amortization of the revalued assets, and other acquisition-related adjustments in connection with the Merger. These unaudited pro forma results exclude transaction costs incurred in connection with the Merger. This unaudited pro forma information should not be relied upon as necessarily being indicative of the historical results that would have been obtained if the Merger had actually occurred on those dates, nor of the results that may be obtained in the future.

	Pro Forma Results of Operations	
	Nine Fiscal Months Ended July 1, 2011	Nine Fiscal Months Ended July 2, 2010
	(in thousands)	
Net revenues	$ 130,120	$ 184,411
Net loss	$ (68,807)	$ (3,959)

3. Sale of Real Property

On December 22, 2010, the Company sold certain real property adjacent to its Newport Beach, California headquarters to Uptown Newport L.P. for $23.5 million, which consisted of $21.5 million in cash and a limited partnership interest in the property, which the Company has valued at $2.0 million. The property primarily consists of approximately 25 acres of land, and included two leased buildings, improvements and site development costs. The net book value of the property sold was as follows (in thousands):

	Predecessor
Land	$ 1,662
Land and leasehold improvements, net	356
Buildings, net	5,610
Machinery and equipment, net	262
Site development costs	7,583
	$ 15,473

The Company has continuing involvement with the property related to groundwater and soil remediation, and therefore at the time of the sale deferred the gain of $6.9 million on the monetary portion of the proceeds of the transaction, net of transaction costs of $0.4 million. The deferred gain was eliminated in the Merger purchase price allocation. Responsibility for soil remediation was transferred to Uptown Newport L.P. with the Company retaining certain obligations to assist in the soil remediation process for up to five years (or earlier under certain circumstances set forth in the agreement between the parties). Responsibility for groundwater remediation remains with the Company in perpetuity, however, upon receipt of a No Further Action letter (NFA Letter) from the appropriate government regulator indicating that the remediation is substantially complete is an indication that the risk of discovery of additional groundwater contamination is remote. The Company has accrued $2.0 million of reserves as of July 1, 2011 based on management s best estimate of remaining remediation costs, of which $1.0 million is classified in long-term other liabilities.

The Company retained an approximately 7.5% limited partnership interest in the property that is recognized at an estimated fair value of $2.0 million. The limited partnership interest holds its limited partnership interest in Uptown Newport L.P., which will own, operate and develop the real property sold by the Company in December 2010. The Company has the option to sell its partnership interest to the developer at $2.0 million plus a 12% return, if Uptown Newport L.P obtains certain financing. The $2.0 million fair market value is derived in large part based on our expectation that the Company will be able to exercise its put option to sell its interest in the partnership within the next

12 months.

4. Fair Value of Certain Financial Assets and Liabilities

Level 1 financial assets and liabilities consist of unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company s cash equivalents consist primarily of funds in money market accounts, which are classified within Level 1 of the fair value hierarchy. Cash equivalents at July 1, 2011 and October 1, 2010 were $32.9 million and $41.9 million, respectively.

Level 2 financial assets and liabilities consist of inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The Company had no financial assets or liabilities classified as Level 2 as of July 1, 2011. The Company had marketable securities of $20.1 million as of October 1, 2010.

Level 3 financial assets and liabilities consist of inputs that are both significant to the fair value measurement and unobservable, and consist of the Company s warrant to purchase approximately 6.1 million shares of Mindspeed common stock at an exercise price of $16.74 per share through June 2013. The fair value of the Mindspeed warrant was $7.5 million and $20.7 million as of July 1, 2011 and October 1, 2010, respectively.

The fair value of other financial instruments, which consist of the Company s 11.25% senior secured notes due 2015, was $198.2 million as of July 1, 2011. The fair value of the 11.25% senior secured notes is based on an indicative bid price provided by the underwriter of the senior secured notes, and was 113.25% of par as of July 1, 2011.

5. Supplemental Financial Information

Inventories

Inventories consist of the following (in thousands):

	Successor July 1, 2011	Predecessor October 1, 2010
Work-in-process	$ 14,154	$ 4,840
Finished goods	5,513	3,907
Total inventories	$ 19,667	$ 8,747

Net inventory as of July 1, 2011 includes $9.7 million step-up to fair value recorded in connection with the Merger, $8.5 million and $1.2 million recorded in work-in-process and finished goods, respectively.

Goodwill and Purchased Intangible Assets

Intangible assets consist of the following (in thousands):

	Successor July 1, 2011				Predecessor October 1, 2010			
	Weighted Average Life (yrs)	Gross Carrying Amount	Accumulated Amortization	Book Value	Weighted Average Life (yrs)	Gross Carrying Amount	Accumulated Amortization	Book Value
Intangible assets subject to amortization:								
Customer relationships	7.0	$ 50,300	$ (2,084)	$ 48,216	5.0	$ 4,300	$ (3,121)	$ 1,179
Backlog	0.5	4,200	(2,652)	1,548				
Patents	8.3	2,900	(70)	2,830	7.5	3,900	(1,333)	2,567
Software licenses					5.0	1,000	(438)	562
Non-compete agreement	1.0	100	(20)	80	5.0	30	(30)	
		$ 57,500	$ (4,826)	$ 52,674		$ 9,230	$ (4,922)	$ 4,308
Intangible assets not subject to amortization:								
In-process research and development		46,000						
Trade name and trademarks		15,100						
		$ 61,100						

Intangible assets are amortized over their estimated useful lives either on a straight-line or accelerated basis that reflects the pattern in which the economic benefits of the intangible assets are expected to be realized, which range from approximately six months to eight years, with no residual value. During the period from April 20, 2011 through July 1, 2011, the Company recognized intangible amortization expense of $4.8 million. During the period from April 2, 2011 through April 19, 2011, and the period from October 2, 2010 through April 19, 2011, the Company recognized intangible amortization expense of $0.1 million and $0.6 million, respectively. During the fiscal quarter and nine fiscal months ended July 2, 2010, the Company recognized intangible amortization expense of $0.3 million and $1.0 million, respectively.

Intangible assets are amortized over a weighted-average remaining period of approximately 6.7 years. Annual amortization expense is expected to be as follows (in thousands):

	Fiscal Year Ending					
	2011	**2012**	**2013**	**2014**	**2015**	**Thereafter**
Amortization expense	$ 4,259	$ 11,713	$ 9,630	$ 7,954	$ 6,585	$ 12,533

Acquired IPR&D intangible assets consist of projects in the Company s audio, imaging and video product lines. All of the projects were in the development phase and were incomplete at the Merger date. If the IPR&D projects reach technological feasibility they will be amortized over their remaining estimated useful lives or, if they do not reach technological feasibility their cost will be charged to expense. Cash flows from

IPR&D intangible assets in fiscal 2011 consist of project expenses. Revenues and gross margin contribution are not expected from IPR&D intangible assets until fiscal 2012.

The changes in the carrying amount of goodwill for the periods ended July 1, 2011 and October 1, 2010, are as follows (in thousands):

	Fiscal Period Ended		
	Successor	**Predecessor**	
	July 1, 2011	**April 19, 2011**	**October 1, 2010**
Goodwill at beginning of period	$ 109,908	$ 109,908	$ 109,908
Predecessor goodwill eliminated in purchase accounting	$ (109,908)	$	$
Excess purchase price atttributed to goodwill acquired	222,661		
Goodwill at end of period	$ 222,661	$ 109,908	$ 109,908

Mindspeed Warrant

The Company has a warrant to purchase approximately 6.1 million shares of Mindspeed common stock at an exercise price of $16.74 per share through June 2013. At July 1, 2011 and October 1, 2010, the market value of Mindspeed common stock was $8.04 and $7.73 per share, respectively. The Company accounts for the Mindspeed warrant as a derivative instrument, and changes in the fair value of the warrant are included in other expense (income), net for each period. At July 1, 2011 and October 1, 2010, the aggregate fair value of the Mindspeed warrant included on the accompanying consolidated balance sheets was $7.5 million and $20.7 million, respectively. At July 1, 2011, the warrant was valued using the Black-Scholes-Merton model with an expected term of 2 years, expected volatility of 65%, a risk-free interest rate of approximately 0.5% and no dividend yield. The aggregate fair value of the warrant is reflected as a long-term asset on the accompanying consolidated balance sheets because the Company does not intend to liquidate any portion of the warrant in the next twelve months.

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

Debt

Debt consists of the following (in thousands):

	Successor	**Predecessor**
	July 1, 2011	**October 1, 2010**
Short-term debt:		
4.00% convertible subordinated notes due March 2026, net of debt discount of $240	$	$ 10,978
Long-term debt:		
11.25% senior secured notes due March 2015, net of premium (discount) of $19,249 and $(1,457)	$ 194,249	$ 173,543

11.25% senior secured notes due 2015 In March 2010, the Company issued $175.0 million aggregate principal amount of senior secured notes due 2015 (senior notes) that mature on March 15, 2015. The senior notes were sold at 99.06% of the principal amount, resulting in gross proceeds of approximately $173.4 million. Deferred debt offering expenses were approximately $4.9 million. The unamortized balance of $3.8 million was eliminated as of the Merger date. The senior notes have not been registered under the Securities Act of 1933, as amended, and may not be sold in the United States absent registration or an applicable exemption from registration requirements. The senior notes accrue interest at a rate of 11.25% per annum payable semiannually on March 15 and September 15 of each year, commencing on September 15, 2010. The obligations under the senior notes are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis, by all of the Company s domestic subsidiaries (except for Conexant CF, LLC, the Company s receivables financing subsidiary). In addition, the senior notes and the note guarantees are secured by liens on substantially all of the Company s and the guarantors tangible and intangible property, subject to certain exceptions and permitted liens. On or after March 15, 2013, the Company may redeem all or a part of the senior notes at a price of 105.625% of the principal amount of the senior notes during the remainder of 2013 and 100.00% of the principal amount of the senior notes thereafter, plus accrued and unpaid interest, if any, to the applicable redemption date. In addition, at any time prior to March 15, 2013, the Company may, on one or more occasions, redeem all or a part of the senior notes at any time at a redemption price equal to 100% of the principal amount of the senior notes redeemed, plus a make-whole premium, plus accrued and unpaid interest, if any, to the applicable redemption date