MINDSPEED TECHNOLOGIES INC
Form 10-K
December 17, 2003

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended September 30, 2003*

Commission file number: 1-31650

Mindspeed Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**01-0616769**
(State of incorporation)	*(I.R.S. Employer Identification No.)*
4000 MacArthur Boulevard **Newport Beach, California**	**92660-3095**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code:

(949) 579-3000

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

Title of each class:	**Name of each exchange on which registered:**
Common Stock, $0.01 par value per share (including associated Preferred Share Purchase Rights)	American Stock Exchange

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

Common Stock, $0.01 par value per share
(including associated Preferred Share Purchase Rights)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The aggregate market value of the Registrant s voting stock held by non-affiliates of the Registrant as of the end of its most recent fiscal year was approximately $499.4 million. Such amount is not presented as of the end of Registrant s most recently completed second fiscal quarter since the Registrant s stock was not publicly traded at that date. Shares of voting stock held by each officer and director and by each shareowner affiliated with a director have been excluded from this calculation because such persons may be deemed to be affiliates. This determination of officer or affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the Registrant s Common Stock as of November 28, 2003 was 94,948,294.

Documents Incorporated by Reference

Portions of the Registrant s Proxy Statement for the 2004 Annual Meeting of Stockholders to be held on February 26, 2004, are incorporated by reference into Part III of this Form 10-K.

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* For presentation purposes of this Form 10-K, references made to the September 30, 2003 period relate to the actual fiscal year ended October 3, 2003.

** The Registrant has voluntarily applied to delist its Common Stock from listing and trading on the American Stock Exchange. As of December 15, 2003, the Registrant s Common Stock is listed and traded on the Nasdaq National Market and is no longer traded on the American Stock Exchange.

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CAUTIONARY STATEMENT

This Annual Report on Form 10-K contains statements relating to Mindspeed Technologies, Inc. (including its future results and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. Actual results or events may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to, those set forth herein under the heading Certain Business Risks, as well as those detailed from time to time in our other filings with the Securities and Exchange Commission. These forward-looking statements are made only as of the date hereof, and we undertake no obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

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PART I

Item 1. *Business*

Mindspeed Technologies, Inc. (we , Mindspeed or the Company) designs, develops and sells semiconductor networking solutions for communications applications in enterprise, access, metropolitan and wide-area networks. Our products, ranging from physical-layer transceivers and framers to higher-layer network processors, are sold to original equipment manufacturers (OEMs) for use in a variety of network infrastructure equipment, including voice and media gateways, high-speed routers, switches, access multiplexers, cross-connect systems, add-drop multiplexers and digital loop carrier equipment. Service providers use this equipment for the processing, transmission and switching of high-speed voice and data traffic within different segments of the communications network.

Our products enable network infrastructure OEMs to design their system-level products with bandwidth flexibility, low power consumption, scalability, upgradeability and high reliability, which we believe allows them to achieve lower total system cost and accelerate their design and production cycles. We believe the breadth of our product portfolio, combined with more than three decades of experience in semiconductor hardware, software and communications systems engineering, provide us with a competitive advantage. We have proven expertise in signal, packet and transmission processing technologies, which are critical core competencies for successfully defining, designing and implementing advanced semiconductor products for next-generation network infrastructure equipment. Our business is fabless, which means we outsource all of our manufacturing needs and we do not own or operate any semiconductor manufacturing facilities. We believe being fabless allows us to minimize operating infrastructure and capital expenditures, maintain operational flexibility and focus our resources on the design, development and marketing of our products the highest value-creation elements of our business model.

Spin-off from Conexant Systems, Inc.

On June 27, 2003, Conexant Systems, Inc. (Conexant) completed the distribution to Conexant shareholders of all outstanding shares of common stock of Mindspeed, then a wholly owned subsidiary of Conexant (the Distribution). In the Distribution, each Conexant shareholder received one share of our common stock, par value $.01 per share (including an associated preferred share purchase right), for every three shares of Conexant common stock held and cash for any fractional share of our common stock. Following the Distribution, we began operations as an independent, publicly held company. Our common stock now trades on the Nasdaq National Market under the ticker symbol MSPD .

Prior to the Distribution, Conexant transferred to us the assets and liabilities of its Mindspeed business, including the stock of certain subsidiaries, and certain other assets and liabilities which were allocated to us under the Distribution Agreement entered into between us and Conexant. Also prior to the Distribution, Conexant contributed to us cash in an amount such that at the time of the Distribution our cash balance was $100 million. We and Conexant also entered into a Credit Agreement, pursuant to which we may borrow up to $50 million for working capital and general corporate purposes and we issued to Conexant a warrant to purchase 30 million shares of our common stock at a price of $3.408 per share, exercisable for a period beginning one year and ending ten years after the Distribution. We and Conexant also entered into an Employee Matters Agreement, a Tax Allocation Agreement, a Transition Services Agreement and a Sublease.

Industry Overview

Background

The telecommunications industry has experienced dramatic growth in the number of Internet users, increasing from a base of approximately 20 million users in 1995 to almost 600 million users by the end of 2002. Consumers and businesses of all sizes increased their use of the Internet for e-mail, on-line shopping, video conferencing and transferring large amounts of stored data. Growth in consumer and business users and applications spurred demand for more bandwidth-intensive data services from service providers. To satisfy this growth in demand, service providers invested aggressively in high-speed, packet-based data networks.

By the end of 2000, many service providers had expanded their networks too rapidly, resulting in industry-wide bandwidth overcapacity significantly exceeding demand growth projections for the next several years. As a result, service provider annual capital spending on network infrastructure equipment, physical plant and support services

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declined significantly in calendar years 2001 and 2002. Beginning in the first calendar quarter of 2001, this sharp decrease in demand for communications semiconductors significantly impacted our revenues and the revenues of our competitors.

Outlook

Despite this setback, we believe the market for network infrastructure equipment in general, and for communications semiconductors in particular, has stabilized and will return to an attractive long term growth trajectory for several reasons:

We believe the imbalance between supply and demand has been significantly reduced in several network equipment market segments, including network access and metropolitan area networks, or metro, service areas and selected enterprise segments.

We anticipate that demand for network capacity will increase, driven by:

Internet user growth;

higher network utilization rates; and

the popularity of new bandwidth-intensive applications, such as wireless data transfer and video/multimedia applications.

We believe that incumbent service providers worldwide will continue to upgrade and expand legacy portions of their networks to accommodate new service offerings and to reduce their recurring cost of operations.

In developing countries, we expect that service providers will continue the build-out of telecommunication networks, many of which were previously government owned.

We expect network infrastructure OEMs to outsource more of their semiconductor component requirements to semiconductor suppliers, allowing the OEMs to reduce their operating cost structure by shifting their focus and investment from internal application specific integrated circuit (ASIC) semiconductor design and development to more strategic systems development.

Addressed Markets and Semiconductor Requirements

Semiconductors will continue to play a critical role in enabling network infrastructure OEMs to meet the needs of their service provider customers in terms of system performance, functionality and time-to-market. Network infrastructure OEMs require new, more advanced communications semiconductor products that are highly optimized for network infrastructure equipment employed by their customers, such as digital signal processors, transceivers, framers, packet and cell processors, and switching solutions.

Our semiconductor products can be incorporated in network infrastructure equipment that is deployed by service providers or businesses in the four segments of the broadly defined communications network: enterprise networks, network access service areas, metropolitan area networks, and wide-area or long-haul networks. We focus primarily on two of these network segments, network access service areas and metropolitan area networks, and continue to expand our presence in a number of enterprise, or internal business network, applications. The type and complexity of network infrastructure equipment used in these segments continues to expand, driven by the need for the processing, transmission and switching of digital voice and data traffic over multiple communication media, at numerous transmission data rates and employing different protocols.

Network Access service areas of the telecommunications network refer to the last mile of a service provider s physical network, including network infrastructure equipment that connects end-users, typically located at a business or residence, with metropolitan area and wide-area networks. For this portion of the network, infrastructure equipment requires semiconductors that enable reliable, high-speed connectivity capable of aggregating or disaggregating and transporting multiple forms of voice and data traffic. In addition, communications semiconductors must accommodate multiple transmission standards and communications protocols to provide a bridge between dissimilar access networks, for example, connecting wireless base station equipment to a wireline network. Typical network infrastructure equipment found at the edge of the network access service area that use our products include remote access concentrators, digital subscriber line (DSL) access multiplexers, voice and media gateways, wireless base stations and optical line termination and media converters.

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Metropolitan Area Networks, or metro, service areas of the telecommunications network refer to the portion of a service provider s physical network that enables high-speed communications within a city or a larger regional area. In addition, it provides the communications link between network access service areas and the fiber optic-based, wide-area network. For metro equipment applications, communications semiconductors provide transmission and processing capabilities, as well as information segmentation and classification, and routing and switching functionality, to support high-speed traffic from multiple sources employing different transmission standards and communications protocols. These functions require signal conversion, signal processing and packet processing expertise to support the design and development of highly integrated mixed-signal devices combining analog and digital functions with communications protocols and application software. Typical network infrastructure equipment found in metro service areas that use our products include add-drop multiplexers, switches, high-speed routers and digital cross-connect systems.

Communications Media and Data Transmission Rates. Copper wire remains the primary wireline communication medium for network access service areas and portions of metro service areas. T-carrier service is the most common digital transmission service standard employed by service providers to deliver high-speed communications for both voice and data traffic over copper wire, and is ideally suited for point-to-point communications requirements for businesses. T-1 and T-3 lines refer to different levels of North American T-carrier service that transmit data at rates of 1.5 and 45 megabits per second (Mbps) respectively. In Europe and portions of Asia, similar services are designated as E-1 and E-3 lines and transmit data at rates of 2 and 34 Mbps, respectively.

Given its superior bandwidth capability, ease of maintenance, improved data integrity and network reliability, fiber optic cable has become the communication medium of choice for wide-area networks and most metro service areas and is increasingly used for broadband network access applications. Synchronous optical network (SONET) is the digital transmission service standard employed by service providers in the Americas and portions of Asia to deliver high-speed voice and data communications and synchronous digital hierarchy (SDH) is the equivalent standard for the majority of the rest of the world. Today, high-speed SONET/ SDH-based connections operate at data transmission rates from 155 Mbps to 2.5 gigabits per second (Gbps) in metro service areas and up to 10 Gbps in long haul networks.

Communications Protocols. Regardless of the selected communications medium or data transmission rate, the movement of all voice and data traffic throughout the telecommunications network requires the use of software intensive communications protocols that govern how information is passed between network infrastructure equipment. Voice and data traffic is transported and switched using two principal types of switching techniques, circuit switching and packet switching, each employing different communications protocols.

Circuit switching, the most common technique for transporting and switching ordinary telephone calls throughout the telecommunications network today, does not use bandwidth efficiently and is not easily scalable to handle significant increases in network data traffic. In response to increased voice and data traffic, service providers accelerated their deployment of network infrastructure equipment that employs packet switching techniques to use more efficiently the available bandwidth to accommodate voice and data traffic. Packet switching transports and switches voice and data traffic that has been segmented into individual frames, cells or packets across the network and reassembles the individual frames, cells or packets at their final destination. Service providers use multiple packet switching protocols, including frame relay (for frame transfer), asynchronous transfer mode (ATM) (for cell transfer), Internet protocol (IP) (for packet transfer), and multiprotocol label switching (MPLS) (for frame, cell and/or packet transfer), in different communications applications.

The telecommunications network, including the Internet, has evolved into a complex, hybrid series of digital and optical networks that connect individuals and businesses globally. These new larger bandwidth, data-centric networks integrate voice and data traffic, operate over both wired and wireless media, link existing voice and data networks and cross traditional enterprise, network access, metro and long haul service area boundaries. Network infrastructure OEMs are designing faster, more intelligent and more complex products to satisfy the needs of the service providers as they continue to expand their network coverage and service offerings while upgrading and connecting or integrating existing networks of disparate types. In this demanding environment, network infrastructure OEMs will select as their strategic partners communications semiconductor suppliers who can deliver advanced products that provide increased functionality, lower total system cost and support for a variety of communications media, operating speeds and protocols.

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The Mindspeed Approach

We believe the breadth of our product portfolio, combined with our expertise in semiconductor hardware, software and communications systems engineering, provide us with a competitive advantage in designing and selling our products to leading network infrastructure OEMs. We have proven expertise in signal, packet and transmission processing technologies. These three core technology competencies are critical for developing semiconductor networking solutions that enable the processing, transmission and switching of high-speed voice and data traffic, employing multiple communications protocols, across disparate communications networks using copper wire or optical fiber as the transport medium. Our three core technology competencies are the foundation for developing our:

Semiconductor device architectures, including digital signal processors, mixed signal devices and programmable protocol engines, as well as analog signal processing capabilities;

Highly optimized, signal processing algorithms and communications protocols, which we implement in semiconductor devices; and

Critical software drivers and application software to perform signal, packet and transmission processing tasks.

Signal Processing

Signal processing involves both signal conversion and digital signal processing techniques that convert and compress voice and data between analog and digital representations. Our portfolio of digital signal processors and reduced instruction set controller-based (RISC-based) processors coupled with our expertise in digital signal processing algorithm development and implementation, enable our products to execute a wide range of modem modulations, echo cancellers, speech coders and communications protocols. Our portfolio of analog signal conversion devices facilitates signal transmission over copper wire across a wide range of signal amplitudes and frequencies.

Packet Processing

Packet processing involves bundling or segmenting information traffic using standard protocols and enables sharing of transmission bandwidth across a given communication medium. Packet processing segments the information to be transmitted into frames, packets or cells, adds destination and origin information and provides error detection and correction capabilities. Packet processing is also used to translate voice and data traffic between different protocols, such as between ATM and IP, and to implement sophisticated traffic management algorithms to control the amount of bandwidth that various communications links use. Our family of network processors is software-programmable and provides advanced protocol translation and traffic management capabilities for frame relay, ATM, IP and MPLS packet processing applications over a variety of communications media and data transmission rates.

Transmission Processing

Transmission processing involves the transport and receipt of voice and data traffic across copper wire and optical fiber communications media. Our portfolio of physical-layer communications devices support transmission processing over T-carrier and SONET/SDH digital transmission services, spanning data transmission rates from 1-2 Mbps to 3 Gbps. Our building-block core devices perform transmit and receive, framing, mapping, multiplexing and de-multiplexing, clock and data recovery, echo cancellation and line equalization functions, which serve as the foundation for these physical-layer and link-layer devices.

Strategy

Our objective is to become the leading supplier of semiconductor networking solutions to leading global network infrastructure OEMs in key metro, network access and enterprise market segments. To achieve this objective, we are pursuing the following strategies:

Focus on Increasing Share in High-Growth, High-Margin Applications

We have established strong positions for our products in the metro and network access service areas of the telecommunications network market that have historically demonstrated solid growth. We believe there is an

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improved balance between supply and demand for network infrastructure equipment and communications semiconductors in the metro and network access service areas as network infrastructure OEM inventories are closer to normal levels and areas of growth are emerging. In addition, products which serve metro and network access applications and perform packet processing, transmission processing and/or signal processing functions typically command higher average selling prices and higher margins, primarily due to their functional complexity and their software content. These two key attributes are expected to make the metro and network access service areas the most attractive market segments for the foreseeable future. We believe that our three core technology competencies, coupled with focused investments in product development, will position us to increase our share in those target areas.

Expand Strategic Relationships with Industry-Leading Global Network Infrastructure OEMs and Maximize Design Win Share

We identify and selectively establish strategic relationships with market leaders in the network infrastructure equipment industry to develop next generation products and, in some cases, customized solutions for their specific needs. We have an extensive history of working closely with our customers research and development and marketing teams to understand emerging markets, technologies and standards and we invest our product development resources in those areas. We believe our close relationships with leading network infrastructure OEMs facilitate early adoption of our products during development of their system-level products, enhance our ability to obtain design wins from those customers and encourage adoption of our technology throughout the industry.

In North America we have cultivated close relationships with leading network infrastructure OEMs, including Cisco Systems, Inc., Juniper Networks, Inc., Lucent Technologies, Inc., McData Corporation and Nortel Networks, Inc. In addition, we have intensified our efforts internationally, particularly in the Asia-Pacific region, and have established close relationships with market leaders such as Fujitsu Limited, Huawei Technologies Co. Ltd., LG Electronics Inc., NEC Corporation, Samsung Electronics Co., Ltd. and Zhongxing Telecom Equipment Corp. (ZTE) in the Asia-Pacific region and Alcatel Data Networks, S.A., Nokia Corporation and Siemens A.G. in Europe.

Capitalize on the Breadth of Our Product Portfolio

We build on the breadth of our product portfolio of physical-layer devices, together with our signal and packet processing devices and communications software expertise, to increase our share of the silicon content in our customers products. We offer a range of complementary products that are optimized to work with each other and provide our customers with complete information receipt, processing and transmission functions. These complementary products allow infrastructure OEMs to source components that provide proven interoperability from a single semiconductor supplier, rather than requiring OEMs to combine and coordinate individual components from multiple vendors. In addition, we provide network infrastructure OEMs with product development roadmaps for the physical integration of discrete components, such as transceivers, framers and mappers, together with the requisite protocol stacks and application software drivers, into a single semiconductor component that performs the same functions previously requiring multiple components. We believe that this strategy of offering both complementary and integrated products increases product performance, speeds time-to-market and lowers the total system cost for our customers.

In addition, we are expanding our broad product portfolio into applications adjacent to network access and metro service areas, such as enterprise applications. This strategy allows us to address new, incremental growth opportunities by building on existing investments.

The breadth of our product portfolio also provides a competitive advantage for serving network convergence applications such as multiprotocol wireless-to-wireline connectivity. These applications generally require a combination of processing, transmission or switching functionality to move high-speed voice and data traffic employing multiple communications protocols across disparate communications networks using copper wire or optical fiber as the transport medium.

Provide Outstanding Technical Support and Customer Service

We provide broad-based technical support, including product design support, to our customers through three dedicated teams: field application engineers, product application engineers and technical marketing personnel. We believe that providing comprehensive service and support is critical to shortening our customers design cycles,

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ensuring the successful launch of their products and maintaining a long-term competitive position within the network infrastructure equipment market. Outstanding customer service and support is becoming a more critical competitive tool as leading network infrastructure OEMs reduce the number of their semiconductor component suppliers to a small preferred list.

Operate as a Fabless Company

We operate as a fabless semiconductor company and outsource all of our manufacturing needs. This allows us to focus our resources on designing, developing and marketing our products while minimizing operating infrastructure costs and capital expenditures. As a result, we maintain maximum flexibility in operations so that we can more rapidly adapt to changes in our customers needs and our target markets.

Products

We provide network infrastructure OEMs with a broad portfolio of advanced semiconductor networking solutions, ranging from physical-layer transceivers and framers to higher-layer network processors. Our products can be classified into four focused product families: high-performance analog products, multiservice access products, T/E carrier products and ATM/ MPLS network processor products. These four product families are found in a variety of networking equipment designed to process, transmit and switch voice and data traffic between, and within, the different segments of the communications network.

High-Performance Analog Products

Our high-performance analog transmission devices and switching solutions support storage, fiber-to-the-premise and Fibre Channel applications, as well as mainstream SONET/ SDH and packet-over-SONET applications, typically operating at data transmission rates between 155 Mbps and 2.5 Gbps. Our transmission products include laser drivers, transimpedance amplifiers, post amplifiers, clock and data recovery circuits and serializers/ deserializers. These products serve as the connection between a fiber optic cable component interface and the remainder of the electrical subsystem in various network equipment and perform a variety of functions including:

Conversion of incoming optical signals from fiber optic cables to electrical signals for processing and transport over a wireline medium and vice-versa;

Conditioning the signal to remove unwanted noise or errors;

Combining lower speed signals from multiple parallel paths into higher speed serial paths, and vice-versa, for bandwidth economy; and

Amplifying weaker signals as they pass through a particular system s equipment or network.

Our switching portfolio includes a family of high-speed crosspoint switches capable of switching traffic within various types of network switching equipment. These crosspoint switches direct, or transfer, a large number of high-speed data input streams, regardless of traffic type, to different connection trunks for rerouting the information to new destination points in the network. Crosspoint switches are often used to provide redundant traffic paths in networking equipment to protect against the loss of critical data from spurious network outages or failures that may occur from time-to-time. Target equipment applications for our switching products include add-drop multiplexers, high-density Internet protocol switches, storage-area routers and optical cross-connect systems. In addition, we recently introduced crosspoint switches optimized for broadcast video routing and production switcher applications.

Multiservice Access Products

Our software configurable multiservice access processor products serve as bridges for transporting voice and data between circuit-switched networks and packet-based networks. Our multiservice access device architecture combines the performance of a digital-signal processor core with the flexibility of a microcontroller core to support our extensive suite of modulation techniques, echo cancellers, speech coders and communications protocols. These products process and translate voice and data signals and perform various management and reporting functions that help determine the appropriate amount of bandwidth required for transporting the signals to the next destination. They compress the signals to minimize bandwidth consumption and modify or add communications protocols to accommodate transport of the signals across a variety of different services and networks. Supported services include

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voice-over-packet (also commonly referred to as voice-over-IP), voice-over-ATM and voice-over-DSL services, as well as wireline to wireless connectivity.

Our foundation Universal Access processor family provides complete hardware and software solutions for receiving and transmitting modem calls from an end-user over the circuit-switched network in equipment such as remote access concentrators and small to mid-range servers. These multi-channel devices then prepare those signals for transport to a new destination over the packet-based Internet backbone.

We also offer a family of next-generation, voice-over-packet communications convergence processors. Our high-density voice-over-IP processor, known as Miro, supports the transport of traffic between and among circuit-switched and packet-switched networks across the entire range of IP and ATM protocols and modulation techniques. Miro is capable of handling more than 300 channels of both voice-over-IP and voice-over-ATM traffic and is targeted for use in digital loop carriers and voice and media gateways designed to bridge wireless, wireline and enterprise networks.

Our voice-over-packet silicon private branch exchange (PBX) processor, known as Chagall, is the industry s first semiconductor system solution to integrate voice processing, packet processing and encryption functionality into a single device for the rapidly growing voice-over-packet enterprise market for internal business networks. Chagall is targeted for use in enterprise voice gateways, packet-enabled PBXs and integrated access devices (IADs).

T/ E Carrier Products

Our T/ E carrier products include physical-layer and link-layer communications device solutions which enable high-speed broadband access. These solutions facilitate the aggregation and transport of voice and data traffic over copper wire from the edge of the network to metropolitan and long-haul networks.

Our T1/ E1 and T3/ E3 carrier devices incorporate high-speed analog, digital and mixed signal circuit technologies and include multi-port framers and line interface units (LIUs) or transceivers for 1.5 Mbps to 45 Mbps data transmission, as well as multi-channel, high-level data link channel (HDLC) protocol controllers. Framers format data for transmission and extract data at reception, while LIUs condition signals for transmission and reception over multiple media. Our multi-port T3/ E3 LIUs with integrated digital jitter attenuation functionality and our integrated T3/ E3 LIU, mapper, multiplexer/ demultiplexer and framing solution are targeted for T/ E carrier to SONET/ SDH network connectivity. These highly integrated, low-power solutions are designed for use in a variety of network equipment including digital loop carriers, access multiplexers, add-drop multiplexers, central office switches, digital cross-connect systems and multiservice provisioning platforms.

Our T/ E carrier products are complemented by a family of symmetric DSL (SDSL) transceivers which enable service providers to deliver Internet access at data transmission rates of 1.5 Mbps to 4.6 Mbps in both directions over copper wire, supporting telecommuting and branch office functions in North America. SDSL solutions employ advanced digital signal processing techniques that enable the delivery of dedicated high-speed data transmission over copper wires within the local loop to end-users at a lower price than traditional T/ E lines. Our DSL transceiver family includes low power, single-port and multi-port DSL products utilizing the next generation DSL standard called G.shdsl. G.shdsl enables simultaneous voice and data communications at data transmission rates up to 4.6 Mbps over copper wire pairs for global DSL applications and over longer distances than SDSL-based solutions.

ATM/ MPLS Network Processor Products

Our high-performance ATM/ MPLS network processors are designed to offer advanced protocol translation and traffic management capabilities normally performed by complex and costly ASICs. Protocol translation occurs where different types of networks and protocols interconnect. Traffic management describes a collection of functions which are used to allocate optimally network bandwidth and allow service providers to provide differentiated services over their networks. Our software-programmable devices operate at data transmission rates from 1.5 Mbps to 2.5 Gbps.

Our network processor devices address internetworking applications, including ATM segmentation and reassembly, and a variety of traffic management functions, including traffic shaping, traffic policing and queue management, required by these applications. Segmentation and reassembly supports the interconnection of ATM and packet-based networks, such as packet over SONET, frame relay or Ethernet. Traffic shaping regulates the time and rate at which various categories of traffic can be sent onto the network. Traffic policing monitors traffic coming

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into a port from the network and ensures that it conforms to predetermined policies. Queue management involves the prioritization of traffic throughout the network.

Customers

We market and sell our semiconductor networking solutions directly to leading network infrastructure OEMs. We also sell our products indirectly through electronic component distributors and third-party electronic manufacturing service providers, who manufacture products incorporating our semiconductor networking solutions for OEMs. Our top five direct OEM customers for fiscal year 2003 were Alcatel Data Networks, S.A., Cisco Systems, Inc., Fujitsu Limited, Nokia Corporation and Nortel Networks, Inc. While our direct sales to these customers accounted for a total of approximately 10% of our fiscal 2003 net revenues, we believe indirect sales to these same customers represent a significant additional portion of our net revenues. Including indirect sales, we believe that Cisco Systems, Inc. accounted for approximately 15% of our fiscal 2003 net revenues and that no other OEM customer accounted for 10% or more of our net revenues. We believe that significant indirect network infrastructure OEM customers for our products for fiscal year 2003 also included ADC Telecommunications, Inc., Huawei Technologies Co., Ltd., McData Corporation, Siemens A.G. and ZTE. Sales to distributors accounted for approximately 58% of our revenues for fiscal 2003. For fiscal 2003, distributors Avnet, Inc. and Alltek Technology Corporation accounted for 22% and 12%, respectively, of our net revenues; no other direct customer accounted for 10% or more of our net revenues. Revenues derived from customers located in the Americas, Europe, and the Asia-Pacific region were 51%, 15% and 34%, respectively, for fiscal year 2003. See Note 13 of Notes to Consolidated Financial Statements.

Sales, Marketing and Technical Support

We have a worldwide sales, marketing and technical support organization comprised of approximately 120 employees as of October 31, 2003, located in 6 domestic and 12 international sales locations. Our marketing, sales and field applications engineering teams, augmented by 19 electronic component distributors and 19 sales representative organizations, focus on marketing and selling semiconductor networking solutions to worldwide network infrastructure OEMs.

We maintain close working relationships with our customers throughout their lengthy product development cycle. Our customers may need six months or longer to test and evaluate our products and an additional six months or longer to begin volume production of network infrastructure equipment that incorporates our products. During this process, we provide broad-based technical support to our customers through our field application engineers, product application engineers and technical marketing personnel. We believe that providing comprehensive product service and support is critical to shortening our customers design cycles and maintaining a competitive position in the network infrastructure equipment market. See Certain Business Risks Because of the lengthy sales cycles of many of our products, we may incur significant expenses before we generate any revenues related to those products.

Operations and Manufacturing

We are a fabless company, which means we do not own or operate foundries for wafer fabrication or facilities for device assembly and final test of our products. Instead, we outsource wafer fabrication, assembly and testing of our semiconductor products to independent, third-party contractors. We use mainstream digital complementary metal-oxide semiconductor (CMOS) process technology for the majority of our products; we rely on specialty processes for the remainder of products. Taiwan Semiconductor Manufacturing Co., Ltd. (TSMC) is our principal foundry supplier of CMOS wafers and die. Our primary foundry supplier for specialty process requirements is Jazz Semiconductor. We use several other suppliers for wafers used in older or low-volume products.

Semiconductor wafers are usually shipped to third-party contractors for device assembly and packaging where the wafers are cut into individual die, packaged and tested before final shipment to customers. We use Amkor Technology, Inc. and other third-party contractors, located in the Asia-Pacific region, Europe, Mexico and California, to satisfy a variety of assembly and packaging technology and product testing requirements associated with the back-end portion of the manufacturing process.

We qualify each of our foundry and back-end process providers. This qualification process consists of a detailed technical review of process performance, design rules, process models, tools and support, as well as analysis of the subcontractor s quality system and manufacturing capability. We also participate in quality and reliability monitoring through each stage of the production cycle by reviewing electrical and parametric data from our wafer

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foundry and back-end providers. We closely monitor wafer foundry production for overall quality, reliability and yield levels.

Competition

The communications semiconductor industry in general, and the markets in which we compete in particular, are intensely competitive. We compete worldwide with a number of U.S. and international suppliers that are both larger and smaller than us in terms of resources and market share. We expect intense competition to continue.

Our principal competitors are Agere Systems, Inc., Applied Micro Circuits Corporation, Centillium Communications, Inc., Exar Corporation, GlobespanVirata, Inc., Infineon Technologies A.G., Integrated Device Technology, Inc., Intel Corporation, Maxim Integrated Products, Inc., PMC-Sierra, Inc., Texas Instruments Incorporated, Transwitch Corporation and Vitesse Semiconductor Corporation.

We believe that the principal competitive factors for semiconductor suppliers in each of our served markets are:

time-to-market;

product quality, reliability and performance;

customer support;

price and total system cost;

new product innovation; and

compliance with industry standards.

While we believe that we compete favorably with respect to each of these factors, many of our current and potential competitors have certain advantages over us, including:

stronger financial position and liquidity;

longer presence in key markets;

greater name recognition;

access to larger customer bases; and

significantly greater sales and marketing, manufacturing, distribution, technical and other resources.

As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or may be able to devote greater resources to the development, promotion and sale of their products than we can. Moreover, we have recently incurred substantial operating losses and we anticipate future losses. Our OEM customers may choose semiconductor suppliers whom they believe have a stronger financial position or liquidity.

Backlog

Our sales are made primarily pursuant to standard purchase orders for delivery of products, with the purchase orders officially acknowledged by us according to our own terms and conditions. Because industry practice allows customers to cancel orders with limited advance notice to us prior to shipment, we believe that backlog as of any particular date is not a reliable indicator of our future revenue levels.

Research and Development

We have significant research, development, engineering and product design capabilities. As of October 31, 2003, we had approximately 400 employees engaged in research and development activities. We perform research and product development activities at our headquarters in

Newport Beach, California and at 6 design centers throughout the world. Our design centers are strategically located to take advantage of key technical and engineering talent.

Our success depends to a substantial degree upon our ability to develop and introduce in a timely fashion new products and enhancements to our existing products that meet changing customer requirements and emerging industry standards. We have made and plan to make substantial investments in research and development and to

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participate in the formulation of industry standards. In addition, we actively collaborate with technology leaders to define and develop next-generation technologies.

We spent approximately $106.3 million, $167.1 million and $196.6 million in fiscal 2003, 2002 and 2001, respectively, on research and development activities.

Intellectual Property

Our success and future revenue growth depend, in part, on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws, as well as employee and third-party nondisclosure and confidentiality agreements and other methods to protect our proprietary technologies and processes. We believe that intellectual property, including patents, patent applications, licenses and trademarks are of material importance to our business. In addition to protecting our proprietary technologies and processes, we constantly strive to strengthen and enhance our intellectual property portfolio. We use the portfolio to seek licensing opportunities, to negotiate cross-licenses with others, and to avoid, defend against or settle litigation against us or our customers pursuant to indemnification obligations. In connection with our participation in the development of various industry standards, we may be required to license certain of our patents to other parties, including competitors that develop products based upon the adopted industry standards. We have also entered into agreements with certain of our customers and granted these customers the right to use our proprietary technology in the event we default in our contractual obligations, including product supply obligations, and fail to cure the default within a specified period of time. While in the aggregate our patents, patent applications, licenses and trademarks are considered important to our operations, no single one is considered of such importance that its loss or termination would materially affect our business or financial condition.

See Certain Business Risks We may be subject to claims of infringement of third-party intellectual property rights or demands that we license third-party technology, which could result in significant expense and reduction in our intellectual property rights.

Employees

As of October 31, 2003, we had approximately 650 full-time employees, of whom approximately 445 were engineers. Our employees are not covered by any collective bargaining agreements and we have not experienced a work stoppage in the past five years.

We believe our future success will depend in large part on our ability to continue to attract, motivate, develop and retain highly skilled and dedicated technical, marketing and management personnel.

Cyclicality

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles and wide fluctuations in product supply and demand. From time to time these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry, and in our business in particular. See Certain Business Risks We have recently experienced the worst downturn in the history of the highly cyclical semiconductor industry, resulting in a dramatic decline in our revenues.

In addition, our operating results are subject to substantial quarterly and annual fluctuations due to a number of factors, such as demand for network infrastructure equipment, the timing of receipt, reduction or cancellation of significant orders, the gain or loss of significant customers, market acceptance of our products and our customers products, our ability to develop, introduce and market new products and technologies on a timely basis, availability and cost of products from our suppliers, new product and technology introductions by competitors, intellectual property disputes, and the timing and extent of product development costs.

Certain Business Risks

Our business, financial condition and operating results can be affected by a number of factors, including those listed below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results. Any of these risks could also materially and adversely affect our business, financial condition or the price of our common stock or other securities.

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We are incurring substantial operating losses, we anticipate additional future losses and we must significantly increase our revenues to become profitable.

We incurred net losses of $750.4 million ($177.3 million, before the $573.2 million cumulative effect of a change in accounting for goodwill) in fiscal 2003, $668.3 million in fiscal 2002 and $496.4 million in fiscal 2001. We face an environment of sharply diminished demand in many of the markets for our products and lower levels of capital spending by service providers who purchase equipment containing our products. We expect that we will continue to incur significant operating losses in the near term.

In order to return to profitability, we must achieve substantial revenue growth. Revenue growth will depend on renewed demand for network infrastructure equipment that incorporates our products, which in turn depends primarily on capital spending levels of communications service providers. Although we have implemented a number of expense reduction and restructuring initiatives to more closely align our cost structure with the current business environment, expense reductions alone, without revenue growth, will not return us to profitability. We cannot assure you as to whether or when we will return to profitability or whether we will be able to sustain such profitability, if achieved.

We have substantial cash requirements to fund our operations, research and development efforts and capital expenditures. Our capital resources are limited and capital needed for our business may not be available when we need it.

For the fourth quarter and fiscal year ended September 30, 2003, our net cash burn (the sum of our net cash used in operating activities and net cash used in investing activities) was $25.1 million and $119.6 million, respectively. Prior to the Distribution, we relied on funding from Conexant together with cash generated from product sales to fund our cash requirements. Our principal sources of liquidity are our existing cash reserves (approximately $80.1 million as of September 30, 2003) and available borrowings under a $50 million credit facility with Conexant. We believe that our existing sources of liquidity, along with cash expected to be generated from product sales, will be sufficient to fund our operations, research and development efforts, anticipated capital expenditures, working capital and other financing requirements for at least the next twelve months. However, we cannot assure you that this will be the case, and if we continue to incur operating losses and negative cash flows in the future, we may need to reduce further our operating costs or obtain alternate sources of financing, or both, to remain viable. We cannot assure you that we will have access to additional sources of capital on favorable terms or at all.

We have recently experienced the worst downturn in the history of the highly cyclical semiconductor industry, resulting in a dramatic decline in our revenues.

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles and wide fluctuations in product supply and demand. From time to time these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry, and in our business in particular. Periods of industry downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. These factors have caused substantial fluctuations in our revenues and our results of operations. We have in the past experienced these cyclical fluctuations in our business and may experience cyclical fluctuations in the future.

During the late 1990 s and extending into 2000, the semiconductor industry in general, and communications applications in particular, enjoyed unprecedented growth, benefiting from the rapid expansion of the Internet and other communication services worldwide. Since fiscal 2001, we like many of our customers and competitors have been adversely affected by an abrupt decline in demand for many of the end-user products that incorporate our products. The impact of weakened end-customer demand has been compounded by higher than normal levels of equipment and component inventories held by many of our OEM, subcontractor and distributor customers. These conditions have represented the worst downturn in the history of the semiconductor industry, and the market for communications semiconductor products has been impacted more adversely than the industry as a whole. We cannot assure you as to whether or when market conditions will improve to the extent necessary for us to return to profitability.

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We are entirely dependent upon third parties for the manufacture, assembly and test of our products and are vulnerable to their capacity constraints during times of increasing demand for semiconductor products.

We are entirely dependent upon outside wafer fabrication facilities, known as foundries, for wafer fabrication services. Under our fabless business model, our long-term revenue growth is dependent on our ability to obtain sufficient external manufacturing capacity, including wafer production capacity. Periods of upturns in the semiconductor industry may be characterized by rapid increases in demand and a shortage of wafer fabrication capacity, and we may experience delays in shipments or increased manufacturing costs.

The significant risks associated with our reliance on third-party foundries are compounded at times of increasing demand for semiconductor products. They include:

the lack of assured wafer supply, potential wafer shortages and higher wafer prices;

limited control over delivery schedules, manufacturing yields, production costs and product quality; and

the unavailability of, or delays in obtaining, products or access to key process technologies.

We obtain external wafer manufacturing capacity primarily from TSMC and Jazz Semiconductor. However, these and other foundries we use may allocate their limited capacity to fulfill the production requirements of other customers that are larger and better financed than we. If we choose to use a new foundry, it typically takes several months to complete the qualification process before we can begin shipping products from the new foundry.

We are also dependent upon third parties, including Amkor, for the assembly and test of our products. Our reliance on others to assemble and test our products subjects us to many of the same risks as are described above with respect to our reliance on outside wafer fabrication facilities.

Wafer fabrication processes are subject to obsolescence, and foundries may discontinue a wafer fabrication process used for certain of our products. In such event, we generally offer our customers a last-time buy program to satisfy their anticipated requirements for our products. The unanticipated discontinuation of a wafer fabrication process on which we rely may adversely affect our revenues and our customer relationships.

The foundries and other suppliers on whom we rely may experience financial difficulties or suffer disruptions in their operations due to causes beyond our control, including labor strikes, work stoppages, electrical power outages, fire, earthquake, flooding or other natural disasters. Certain of our suppliers manufacturing facilities are located near major earthquake fault lines in the Asia-Pacific region, Mexico and California. In the event of a disruption of the operations of one or more of our suppliers, we may not have a second manufacturing source immediately available. Such an event could cause significant delays in shipments until we could shift the products from an affected facility or supplier to another facility or supplier. The manufacturing processes we rely on are specialized and are available from a limited number of suppliers. Alternate sources of manufacturing capacity, particularly wafer production capacity, may not be available to us on a timely basis. Even if alternate wafer production capacity is available, we may not be able to obtain it on favorable terms, or at all. Difficulties or delays in securing an adequate supply of our products on favorable terms, or at all, could impair our ability to meet our customers requirements and have a material adverse effect on our operating results.

In addition, the highly complex and technologically demanding nature of semiconductor manufacturing has caused foundries to experience, from time to time, lower than anticipated manufacturing yields, particularly in connection with the introduction of new products and the installation and start-up of new process technologies. Lower than anticipated manufacturing yields may affect our ability to fulfill our customers demands for our products on a timely basis. Moreover, lower than anticipated manufacturing yields may adversely affect our cost of goods sold and our results of operations.

We are subject to intense competition.

The communications semiconductor industry in general, and the markets in which we compete in particular, are intensely competitive. We compete worldwide with a number of United States and international semiconductor manufacturers that are both larger and smaller than us in terms of resources and market share. We currently face significant competition in our markets and expect that intense price and product competition will continue. This competition has resulted, and is expected to continue to result, in declining average selling prices for our products.

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Many of our current and potential competitors have certain advantages over us, including:

- stronger financial position and liquidity;
- longer presence in key markets;
- greater name recognition;
- access to larger customer bases; and
- significantly greater sales and marketing, manufacturing, distribution, technical and other resources.

As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or may be able to devote greater resources to the development, promotion and sale of their products than we can. Moreover, we have recently incurred substantial operating losses and we anticipate future losses. Our OEM customers may choose semiconductor suppliers whom they believe have a stronger financial position or liquidity.

Current and potential competitors also have established or may establish financial or strategic relationships among themselves or with our existing or potential customers, resellers or other third parties. These relationships may affect customers purchasing decisions. Accordingly, it is possible that new competitors or alliances among competitors could emerge and rapidly acquire significant market share. We cannot assure you that we will be able to compete successfully against current and potential competitors.

Our success depends on our ability to develop competitive new products in a timely manner.

Our operating results will depend largely on our ability to continue to introduce new and enhanced semiconductor products on a timely basis. Successful product development and introduction depends on numerous factors, including, among others:

- our ability to anticipate customer and market requirements and changes in technology and industry standards;
- our ability to accurately define new products;
- our ability to complete development of new products, and bring our products to market, on a timely basis;
- our ability to differentiate our products from offerings of our competitors; and
- overall market acceptance of our products.

We cannot assure you that we will have sufficient resources to make the substantial investment in research and development in order to develop and bring to market new and enhanced products, particularly if we are required to take further cost reduction actions. Furthermore, we are required to continually evaluate expenditures for planned product development and to choose among alternative technologies based on our expectations of future market growth. We cannot assure you that we will be able to develop and introduce new or enhanced products in a timely manner, that our products will satisfy customer requirements or achieve market acceptance, or that we will be able to anticipate new industry standards and technological changes. We also cannot assure you that we will be able to respond successfully to new product announcements and introductions by competitors.

If we are not able to keep abreast of the rapid technological changes in our markets, our products could become obsolete.

The demand for our products can change quickly and in ways we may not anticipate because our markets generally exhibit the following characteristics:

- rapid technological developments;
- rapid changes in customer requirements;

frequent new product introductions and enhancements;

declining prices over the life cycle of products; and

evolving industry standards.

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Our products could become obsolete sooner than anticipated because of a faster than anticipated change in one or more of the technologies related to our products or in market demand for products based on a particular technology, particularly due to the introduction of new technology that represents a substantial advance over current technology. Currently accepted industry standards are also subject to change, which may contribute to the obsolescence of our products.

The complexity of our products may lead to errors, defects and bugs, which could subject us to significant costs or damages and adversely affect market acceptance of our products.

Although we, our customers and our suppliers rigorously test our products, products as complex as ours may contain errors, defects or bugs when first introduced or as new versions are released. We have in the past experienced, and may in the future experience, such errors, defects and bugs. If any of our products contain production defects or reliability, quality or compatibility problems that are significant to our customers, our reputation may be damaged and customers may be reluctant to buy our products, which could adversely affect our ability to retain existing customers and attract new customers. In addition, these defects or bugs could interrupt or delay sales of affected products to our customers, which could adversely affect our results of operations.

If defects or bugs are discovered after commencement of commercial production of a new product, we may be required to make significant expenditures of capital and other resources to resolve such problems. This could result in significant additional development costs and the diversion of technical and other resources from our other development efforts. We could also incur significant costs to repair or replace defective products and we could be subject to claims for damages by our customers or others against us. Such costs or damages could have a material adverse effect on our financial condition and results of operations.

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

Our future success depends on our ability to attract, retain and motivate qualified personnel, including executive officers and other key management and technical personnel. As the source of our technological and product innovations, our key technical personnel represent a significant asset. The competition for such personnel can be intense in the semiconductor industry. We cannot assure you that we will be able to attract and retain qualified management and other personnel necessary for the design, development and sale of our products.

Approximately 10% of our engineers are foreign nationals working in the United States under visas. The visas held by many of our employees permit qualified foreign nationals working in specialty occupations, such as certain categories of engineers, to reside in the United States during their employment. The number of new visas approved each year may be limited and may restrict our ability to hire additional qualified technical employees. In addition, immigration policies are subject to change, and these policies have generally become more stringent since the events of September 11, 2001. Any additional significant changes in immigration laws, rules or regulations may further restrict our ability to retain or hire technical personnel.

We may have particular difficulty attracting and retaining key personnel during periods of poor operating performance. Our recent expense reduction and restructuring initiatives, including a series of worldwide workforce reductions, have significantly reduced the number of our technical employees. The loss of the services of one or more of our key employees, including Raouf Y. Halim, our chief executive officer, or certain key design and technical personnel, or our inability to attract, retain and motivate qualified personnel could have a material adverse effect on our ability to operate our business.

If network infrastructure OEMs do not design our products into their equipment, we will be unable to sell those products. Moreover, a design win from a customer does not guarantee future sales to that customer.

Our products are not sold directly to the end-user but are components of other products. As a result, we rely on network infrastructure OEMs to select our products from among alternative offerings to be designed into their equipment. We may be unable to achieve these design wins. Without design wins from OEMs, we would be unable to sell our products. Once an OEM designs another supplier s semiconductors into one of its product platforms, it will be more difficult for us to achieve future design wins with that OEM s product platform because changing suppliers involves significant cost, time, effort and risk. Achieving a design win with a customer does not ensure that we will receive significant revenues from that customer and we may be unable to convert design wins

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into actual sales. Even after a design win, the customer is not obligated to purchase our products and can choose at any time to stop using our products if, for example, its own products are not commercially successful.

Because of the lengthy sales cycles of many of our products, we may incur significant expenses before we generate any revenues related to those products.

Our customers may need six months or longer to test and evaluate our products and an additional six months or more to begin volume production of equipment that incorporates our products. This lengthy period of time required also increases the possibility that a customer may decide to cancel or change product plans, which could reduce or eliminate sales to that customer. As a result of this lengthy sales cycle, we may incur significant research and development, and selling, general and administrative expenses before we generate the related revenues for these products, and we may never generate the anticipated revenues if our customer cancels or changes its product plans.

Uncertainties involving the ordering and shipment of our products could adversely affect our business.

Our sales are typically made pursuant to individual purchase orders and we generally do not have long-term supply arrangements with our customers. Generally, our customers may cancel orders until 30 days prior to shipment. In addition, we sell a substantial portion of our products through distributors, some of whom have a right to return unsold products to us. Sales to distributors accounted for approximately 58% of our net revenues for fiscal 2003. We routinely purchase inventory based on estimates of end-market demand for our customers products, which is difficult to predict. This difficulty may be compounded when we sell to OEMs indirectly through distributors or contract manufacturers, or both, as our forecasts of demand are then based on estimates provided by multiple parties. In addition, our customers may change their inventory practices on short notice for any reason. The cancellation or deferral of product orders, the return of previously sold products or overproduction due to the failure of anticipated orders to materialize could result in our holding excess or obsolete inventory, which could result in write-downs of inventory.

The network infrastructure markets we address have been characterized by dramatic changes in end-user demand and levels of channel inventories that reduce visibility into future demand for our products. As a result of sharply reduced demand across our product portfolio, in fiscal 2001 we recorded $83.5 million of inventory write-downs.

We are subject to the risks of doing business internationally.

For fiscal 2003, approximately 60% of our net revenues were from customers located outside the United States, primarily in the Asia-Pacific region and Europe. In addition, we have design centers and suppliers located outside the United States, including foundries and assembly and test service providers located in the Asia-Pacific region. Our international sales and operations are subject to a number of risks inherent in selling and operating abroad. These include, but are not limited to, risks regarding:

currency exchange rate fluctuations;

local economic and political conditions;

disruptions of capital and trading markets;

restrictive governmental actions (such as restrictions on the transfer or repatriation of funds and trade protection measures, including export duties and quotas and customs duties and tariffs);

changes in legal or regulatory requirements;

difficulty in obtaining distribution and support;

the laws and policies of the United States and other countries affecting trade, foreign investment and loans, and import or export licensing requirements;

tax laws; and

limitations on our ability under local laws to protect our intellectual property.

Because most of our international sales, other than sales to Japan (which are denominated principally in Japanese yen), are currently denominated in U.S. dollars, our products could become less competitive in international markets if the value of the U.S. dollar increases relative to foreign currencies. We cannot assure you

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that the factors described above will not have a material adverse effect on our ability to increase or maintain our foreign sales.

We enter into foreign currency forward exchange contracts to minimize risk of loss from currency exchange rate fluctuations for foreign currency commitments entered into in the ordinary course of business. We have not entered into foreign currency forward exchange contracts for other purposes. Our financial condition and results of operations could be affected (adversely or favorably) by currency fluctuations.

Our operating results may be negatively affected by substantial quarterly and annual fluctuations and market downturns.

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

changes in end-user demand for the products manufactured and sold by our customers;

the timing of receipt, reduction or cancellation of significant orders by customers;

the gain or loss of significant customers;

market acceptance of our products and our customers products;

our ability to develop, introduce and market new products and technologies on a timely basis;

the timing and extent of product development costs;

new product and technology introductions by competitors;

fluctuations in manufacturing yields;

significant warranty claims, including those not covered by our suppliers;

availability and cost of products from our suppliers;

intellectual property disputes; and

the effects of competitive pricing pressures, including decreases in average selling prices of our products.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly or annual operating results. If our operating results fail to meet the expectations of analysts or investors, it could materially and adversely affect the price of our common stock.

We may be subject to claims of infringement of third-party intellectual property rights or demands that we license third-party technology, which could result in significant expense and reduction in our intellectual property rights.

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

pay substantial damages for past, present and future use of the infringing technology;

cease the manufacture, use or sale of infringing products;

discontinue the use of infringing technology;

expend significant resources to develop non-infringing technology;

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pay substantial damages to our customers or end users to discontinue use and/or replace infringing technology with non-infringing technology;

license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all; or

relinquish intellectual property rights associated with one or more of our patent claims, if such claims are held invalid or otherwise unenforceable.

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

We rely primarily on patent, copyright, trademark and trade secret laws, as well as employee and third-party nondisclosure and confidentiality agreements and other methods, to protect our proprietary technologies and processes. At times we incorporate the intellectual property of our customers into our designs, and we have obligations with respect to the non-use and non-disclosure of their intellectual property. In the past, we have engaged in litigation to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of proprietary rights of others, including our customers. We may engage in future litigation on similar grounds, which may require us to expend significant resources and to divert the efforts and attention of our management from our business operations. We cannot assure you that:

the steps we take to prevent misappropriation or infringement of our intellectual property or the intellectual property of our customers will be successful;

any existing or future patents will not be challenged, invalidated or circumvented; or

any of the measures described above would provide meaningful protection.

Despite these preventive measures and precautions, it may be possible for a third party to copy or otherwise obtain and use our technology without authorization, develop similar technology independently or design around our patents. If any of our patents fails to protect our technology it would make it easier for our competitors to offer similar products. In addition, effective patent, copyright, trademark and trade secret protection may be unavailable or limited in certain countries.

Our success may depend, in part, on our ability to successfully integrate businesses we may acquire.

We may from time to time make acquisitions, enter into alliances or make investments to complement our existing product offerings, augment our market coverage or enhance our technological capabilities. However, if we consummate such transactions, they could result in:

issuances of equity securities dilutive to our existing shareholders;

the incurrence of substantial debt and assumption of unknown liabilities;

large one-time write-offs;

amortization expenses related to intangible assets;

the diversion of management s attention from other business concerns; and

the potential loss of key employees from the acquired business.

Additionally, in periods subsequent to an acquisition, we must evaluate goodwill and acquisition-related intangible assets for impairment. When such assets are found to be impaired, they will be written down to estimated fair value, with a charge against earnings.

Integrating acquired organizations and their products and services may be expensive, time-consuming and a strain on our resources and our relationships with employees and customers, and ultimately may not be successful.

We have a limited operating history as an independent company, and potential concerns about our prospects as an independent company could affect our ability to attract and retain customers and employees.

The historical financial information included in this Annual Report for periods prior to the Distribution has been derived from Conexant s consolidated financial statements and does not reflect what our financial position, results of operations and cash flows would have been if we had operated as an independent public company during

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those periods. In addition, the historical information is not necessarily indicative of what our results of operations, financial position and cash flows will be in the future.

As an independent public company, we are dependent on our own resources to operate our business and, except for the $50 million credit facility with Conexant, we no longer have access to Conexant s resources. If we are not successful in assuring our customers and employees of our financial stability and our prospects for success as an independent company, our customers may choose other suppliers and our employees may seek other employment, which may materially adversely affect our business.

Our securities have a limited trading history, and our stock price may fluctuate significantly.

Our common stock began trading publicly on June 30, 2003. Our common stock is listed and traded on the Nasdaq National Market under the trading symbol MSPD . There can be no assurance as to the prices at which trading in our common stock will occur in the future and the market price of our common stock may fluctuate significantly. We cannot assure you that an active trading market in our common stock will be sustained in the future. The market price at which shares of our common stock will trade will be determined by the marketplace and may be influenced by many factors, including:

our operating and financial performance and prospects;

the depth and liquidity of the market for our common stock;

investor perception of us and the industry in which we operate;

the level of r