CONEXANT SYSTEMS INC
Form 10-Q
February 10, 2003

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

FORM 10-Q

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

For the quarterly period ended December 31, 2002*

OR

[ ]	**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.)

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

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

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 [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act). Yes [X] No [ ]

Number of shares of registrant s common stock outstanding as of January 31, 2003 was 266,509,823.

* For presentation purposes of this Form 10-Q, references made to the December 31, 2002 period relate to the actual fiscal first quarter ended December 27, 2002.

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CAUTIONARY STATEMENT

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

Mindspeed Technologies is a trademark of Conexant Systems, Inc. Other brands, names and trademarks contained in this Quarterly Report are the property of their respective owners.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONEXANT SYSTEMS, INC.
Consolidated Condensed Balance Sheets
(unaudited, in thousands, except per share amounts)

	December 31, 2002	September 30, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 234,562	$ 168,357
Short-term investments	162,543	99,466
Notes receivable from Skyworks		180,000
Receivables, net of allowance of $6,045 and $8,405 at December 31, 2002 and September 30, 2002, respectively	75,252	73,552
Inventories	70,830	57,330
Deferred income taxes	32,258	32,233
Other current assets	41,083	52,695
Total current assets	616,528	663,633
Property, plant and equipment, net	82,761	93,994
Goodwill	621,621	615,326
Intangible assets, net	138,593	157,876
Deferred income taxes	224,445	224,168
Other assets	159,995	156,038
Total assets	$ 1,843,943	$ 1,911,035
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 88,916	$ 101,342
Deferred revenue	7,744	10,420
Accrued compensation and benefits	36,208	38,929
Other current liabilities	71,115	71,738
Total current liabilities	203,983	222,429
Convertible subordinated notes	681,825	681,825
Other liabilities	54,864	58,954
Total liabilities	940,672	963,208
Commitments and contingencies		
Shareholders equity:		
Preferred and junior preferred stock		
Common stock, $1.00 par value: 1,000,000 shares authorized; 265,963 and 265,676 shares issued at December 31, 2002 and September 30, 2002, respectively	265,963	265,676
Additional paid-in capital	3,220,199	3,219,044
Accumulated deficit	(2,559,596)	(2,507,407)

Accumulated other comprehensive loss	(22,332)	(28,077)
Unearned compensation	(963)	(1,409)
Total shareholders equity	903,271	947,827
Total liabilities and shareholders equity	$ 1,843,943	$ 1,911,035

See accompanying notes to consolidated condensed financial statements.

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CONEXANT SYSTEMS, INC.
Consolidated Condensed Statements of Operations
(unaudited, in thousands, except per share amounts)

	Three months ended December 31,	
	2002	**2001**
Net revenues	$ 164,456	$ 141,115
Cost of goods sold	87,599	93,274
Gross margin	76,857	47,841
Operating expenses:		
Research and development	71,467	79,413
Selling, general and administrative	34,907	45,052
Amortization of intangible assets	14,999	85,522
Special charges	10,605	1,000
Total operating expenses	131,978	210,987
Operating loss	(55,121)	(163,146)
Other income (expense), net	3,368	(9,169)
Loss before income taxes	(51,753)	(172,315)
Provision (benefit) for income taxes	436	(2,549)
Loss from continuing operations	(52,189)	(169,766)
Loss from discontinued operations, net of income taxes		(34,724)
Net loss	$ (52,189)	$ (204,490)
Loss per share, basic and diluted:		
Continuing operations	$ (0.20)	$ (0.67)
Discontinued operations		(0.13)
Net loss	$ (0.20)	$ (0.80)
Number of shares used in per share computation	265,714	254,362

See accompanying notes to consolidated condensed financial statements.

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CONEXANT SYSTEMS, INC.
Consolidated Condensed Statements of Cash Flows
(unaudited, in thousands)

	Three months ended December 31,	
	2002	**2001**
Cash flows from operating activities:		
Loss from continuing operations	$ (52,189)	$ (169,766)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities, net of effects of dispositions of businesses:		
Depreciation	9,680	14,170
Amortization of intangible assets	14,999	85,522
Asset impairments	2,386	
Provision for losses on accounts receivable	(2,714)	1,203
Inventory provisions	7,004	10,887
Other non-cash items, net	(1,751)	4,687
Changes in assets and liabilities:		
Receivables	1,008	15,060
Inventories	(20,504)	914
Accounts payable	(12,986)	14,107
Deferred revenue	(2,676)	(5,270)
Accrued expenses and other current liabilities	(3,478)	(28,433)
Other	6,633	5,457
Net cash used in operating activities	(54,588)	(51,462)
Cash flows from investing activities:		
Advances to Skyworks	(35,000)	
Repayment of Term Notes and advances by Skyworks	170,000	
Purchase of marketable securities	(44,615)	(78,683)
Sale of marketable securities	34,929	79,563
Capital expenditures	(4,795)	(6,518)
Proceeds from sales of assets	1,025	20,805
Investments in and advances to businesses	(1,500)	(3,000)
Net cash provided by investing activities	120,044	12,167
Cash flows from financing activities:		
Proceeds from exercise of stock options	749	4,907
Net cash provided by financing activities	749	4,907
Net cash used in discontinued operations		(18,221)
Net increase (decrease) in cash and cash equivalents	66,205	(52,609)
Cash and cash equivalents at beginning of period	168,357	182,260
Cash and cash equivalents at end of period	$ 234,562	$ 129,651

See accompanying notes to consolidated condensed financial statements.

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CONEXANT SYSTEMS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation and Significant Accounting Policies

Conexant Systems, Inc. (Conexant or the Company) designs, develops and sells semiconductor system solutions for communications applications. The Company s expertise in mixed-signal processing allows it to deliver integrated systems and semiconductor products which facilitate communications worldwide through wireline voice and data communications networks and emerging cable, satellite and fixed wireless broadband communications networks. The Company operates in two business segments: the Broadband Communications business and Mindspeed Technologies , the Company s Internet infrastructure business.

On June 25, 2002, Conexant completed the distribution to Conexant shareholders of outstanding shares of Washington Sub, Inc. (Washington), a wholly owned subsidiary of Conexant to which Conexant contributed its wireless communications business, other than certain assets and liabilities which Conexant retained (together, the Spin-off Transaction). Immediately thereafter, Washington merged with and into Alpha Industries, Inc. (Alpha), with Alpha the surviving corporation (the Merger). As a result of the Spin-off Transaction and the Merger, Conexant shareholders received 0.351 of a share of Alpha common stock for each Conexant share held and continued to hold their Conexant shares. Upon completion of the Merger, Alpha and its subsidiaries purchased Conexant s semiconductor assembly, module manufacturing and test facility located in Mexicali, Mexico and Conexant s package design team that supports the Mexicali facility (together, the Mexicali Operations) for $150 million. Effective June 26, 2002, Alpha changed its name to Skyworks Solutions, Inc. (Skyworks).

The operating results of the discontinued wireless communications business and Mexicali Operations (through June 25, 2002) included in the accompanying consolidated condensed statements of operations were as follows (in thousands):

	Three months ended December 31, 2001
Net revenues	$ 88,404
Loss before income taxes	$ (31,175)
Provision for income taxes	3,549
Loss from discontinued operations	$ (34,724)

In September 2000, the Company s Board of Directors approved in principle the separation of the Broadband Communications and Mindspeed Technologies businesses. Although business conditions have delayed the separation, the Company remains committed to completing the separation as soon as business and market conditions permit. The separation may be subject to the approval of the Company s shareholders, the receipt of a ruling from the Internal Revenue Service that any related spin-off will qualify as a tax-free distribution and other conditions. There can be no assurance that the separation will be successfully completed.

In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments, consisting of adjustments of a normal recurring nature, as well as the special charges, necessary to present fairly the Company s financial position, results of operations and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2002.

Fiscal Periods For presentation purposes, references made to the periods ended December 31, 2002 and 2001 relate to the actual fiscal 2003 first quarter ended December 27, 2002 and the actual fiscal 2002 first quarter ended December 28, 2001, respectively.

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CONEXANT SYSTEMS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

Supplemental Cash Flow Information Cash paid for interest was $1.4 million and $2.0 million for the three months ended December 31, 2002 and 2001, respectively. Net income tax payments for the three months ended December 31, 2002 and 2001 were $0.3 million and $1.8 million, respectively.

Recent Accounting Standards The Company adopted Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets as of the beginning of fiscal 2003. SFAS 141 requires that all business combinations be accounted for using the purchase method and provides new criteria for recording intangible assets separately from goodwill. Upon adoption, the existing goodwill and intangible assets were evaluated against the new criteria, which resulted in certain intangible assets with a carrying value of $4.7 million being subsumed into goodwill. SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and requires that goodwill and intangible assets that have indefinite useful lives no longer be amortized into results of operations, but instead be tested at least annually for impairment and written down when impaired. Upon adoption, the Company ceased amortizing goodwill against its results of operations.

SFAS 142 also requires the Company to complete a transition impairment test of its goodwill (as of the beginning of fiscal 2003) no later than the fourth quarter of fiscal 2003. If the recorded value of goodwill exceeds its estimated fair value, the Company will write down the value of goodwill to estimated fair value. Any such transition impairment loss will be recognized as the effect of a change in accounting principle. The Company expects to complete the transition impairment test during the second quarter of fiscal 2003 and expects that the transition impairment test will result in a significant write-down of the value of goodwill. In addition, future periodic impairment tests may result in significant write-downs of the value of goodwill (charged against income).

The following table shows our net loss and our net loss per share, as if the non-amortization provisions of SFAS 142 had been in effect during the three months ended December 31, 2001 (in thousands, except per share amounts):

	Three months ended December 31,	
	2002	**2001**
Net loss, as reported	$(52,189)	$(204,490)
Amortization of goodwill		72,254
Amortization of assembled workforce previously classified as an intangible asset		503
Net loss, as adjusted	$(52,189)	$(131,733)
Net loss per share, basic and diluted:		
As reported	$ (0.20)	$ (0.80)
As adjusted	$ (0.20)	$ (0.52)

SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, supersedes previous guidance on financial accounting and reporting for the impairment or disposal of long-lived assets and for segments of a business to be disposed of. The Company adopted SFAS 144 as of the beginning of fiscal 2003, with no significant impact on its financial position or results of operations. However, future impairment reviews may result in significant charges against earnings to write down the value of long-lived assets.

SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections rescinds SFAS 4, which required gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. The Company adopted SFAS 145 as of the beginning of fiscal 2003. The adoption of SFAS 145 resulted in the reclassification of fiscal 2001 gains of $11.7 million from extraordinary gain on extinguishment of debt to income from continuing operations in the consolidated statements of operations.

In August 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 requires that costs associated with exit or disposal activities

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CONEXANT SYSTEMS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

be recognized when they are incurred rather than at the date of a commitment to an exit or disposal plan. The Company must apply SFAS 146 prospectively to exit or disposal activities initiated after December 31, 2002. If the Company initiates exit or disposal activities after that date, SFAS 146 will affect the timing of the recognition of the related costs. Management does not expect the adoption of SFAS 146 to have a significant impact on the Company s financial position.

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 requires increased financial statement disclosures by a guarantor about its obligations under certain guarantees it has issued. FIN 45 also requires that a guarantor recognize a liability for the fair value of a certain guarantees made after December 31, 2002. The Company adopted the disclosure provisions of FIN 45 in the first quarter of fiscal 2003, with no impact on its financial position or results of operations.

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities. The Company must adopt FIN 46 in the fourth quarter of fiscal 2003 and is currently evaluating the effect, if any, of such adoption on its financial position and results of operations.

Reclassifications Certain prior year amounts have been reclassified to conform to the current period presentation.

2. Supplemental Financial Statement Data

Short-term Investments

Short-term investments consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
December 31, 2002:				
U.S. government agencies	$ 35,443	$ 355	$	$ 35,798
Foreign government securities	8,383	91		8,474
Corporate debt securities	64,363	445	(41)	64,767
Skyworks 15% convertible senior subordinated notes	45,379	3,806		49,185
Equity securities	2,432	1,887		4,319
	$156,000	$ 6,584	$ (41)	$162,543
September 30, 2002:				
U.S. government agencies	$ 24,686	$ 257	$	$ 24,943
Foreign government securities	8,446	102		8,548
Corporate debt securities	65,493	517	(35)	65,975
	$ 98,625	$ 876	$ (35)	$ 99,466

The Company accounts for the Skyworks 15% convertible senior subordinated notes as available-for-sale securities carried at their fair value. Unrealized gains or losses resulting from changes in the fair value of the underlying debt are included in other comprehensive income. The right to convert the Skyworks 15% convertible senior subordinated notes into shares of Skyworks common stock is, for financial accounting purposes, an embedded derivative instrument. Changes in the fair value of the Skyworks 15% convertible senior subordinated notes resulting from changes in the value of the conversion right are included in other income (expense), net each period.

Inventories

Inventories consist of the following (in thousands):

	December 31, 2002	September 30, 2002
Raw materials	$	$ 363
Work-in-process	49,441	39,313
Finished goods	21,389	17,654
	$70,830	