MINDSPEED TECHNOLOGIES, INC
Form 10-Q
May 12, 2004

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 March 31, 2004*

OR

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

Commission file number: 000-50499

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)

(949) 579-3000
(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 [ ] No [X]

Number of shares of registrant s common stock outstanding as of April 30, 2004 was 99,475,631.

* For presentation purposes of this Form 10-Q, references made to the March 31, 2004 period relate to the actual fiscal second quarter ended April 2, 2004.

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CAUTIONARY STATEMENT

This Quarterly Report contains statements relating to future results of Mindspeed Technologies, Inc. (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Secures 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, and actual events that occur, may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: market demand for our new and existing products; availability of capital needed for our business; our ability to reduce our cash consumption; successful development and introduction of new products; obtaining design wins and developing revenues from them; pricing pressures and other competitive factors; order and shipment uncertainty; fluctuations in manufacturing yields; product defects; intellectual property infringement claims by others and the ability to protect our intellectual property; our ability to maintain operating expenses within anticipated levels; and the ability to attract and retain qualified personnel, as well as other risks and uncertainties, including those set forth herein under the heading Certain Business Risks and 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.

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

MINDSPEED TECHNOLOGIES, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MINDSPEED TECHNOLOGIES, INC.

Consolidated Condensed Balance Sheets
(unaudited, in thousands, except per share amounts)

	March 31, 2004	September 30, 2003
ASSETS		
Current Assets		
Cash and cash equivalents	$ 59,636	$ 80,121
Receivables, net of allowance of $874 and $932 at March 31, 2004 and September 30, 2003, respectively	15,697	11,652
Inventories	9,785	4,035
Other current assets	6,171	7,926
Total current assets	91,289	103,734
Property, plant and equipment, net	23,859	26,612
Intangible assets, net	45,679	69,867
Other assets	4,066	3,676
Total assets	$164,893	$203,889
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 6,854	$ 8,110
Deferred revenue	4,884	3,173
Accrued compensation and benefits	9,858	8,424
Restructuring	3,101	7,273
Other current liabilities	2,995	4,971
Total current liabilities	27,692	31,951
Other liabilities	3,897	4,804
Total liabilities	31,589	36,755
Commitments and contingencies		
Shareholders Equity		

Preferred and junior preferred stock		
Common stock, $0.01 par value: 500,000 shares authorized; 99,298 and 93,545 shares issued at March 31, 2004 and September 30, 2003, respectively	993	935
Additional paid-in capital	228,176	215,518
Accumulated deficit	(79,742)	(32,176)
Accumulated other comprehensive loss	(15,994)	(16,959)
Unearned compensation	(129)	(184)
Total shareholders equity	133,304	167,134
Total liabilities and shareholders equity	$164,893	$203,889

See accompanying notes to consolidated condensed financial statements.

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MINDSPEED TECHNOLOGIES, INC.

Consolidated Condensed Statements of Operations
(unaudited, in thousands, except per share amounts)

	Three months ended March 31,		Six months ended March 31,	
	2004	**2003**	**2004**	**2003**
Net revenues	$ 30,750	$ 18,311	$ 57,496	$ 38,566
Cost of goods sold	7,899	5,659	16,027	11,796
Gross margin	22,851	12,652	41,469	26,770
Operating expenses:				
Research and development	20,120	26,190	40,544	57,342
Selling, general and administrative	10,913	13,326	22,873	25,454
Amortization of intangible assets	12,631	12,322	25,107	26,522
Special charges	387	15,407	387	19,238
Total operating expenses	44,051	67,245	88,911	128,556
Operating loss	(21,200)	(54,593)	(47,442)	(101,786)
Other income (expense), net	135	(122)	349	(157)
Loss before income taxes	(21,065)	(54,715)	(47,093)	(101,943)
Provision for income taxes	281	140	473	260
Loss before cumulative effect of accounting change	(21,346)	(54,855)	(47,566)	(102,203)
Cumulative effect of change in accounting for goodwill				(573,184)
Net loss	$(21,346)	$(54,855)	$(47,566)	$(675,387)
Loss per share, basic and diluted:				
Loss before cumulative effect of accounting change	$ (0.22)	$ (0.62)	$ (0.49)	$ (1.15)
Cumulative effect of change in accounting for goodwill				(6.46)

Net loss	$ (0.22)	$ (0.62)	$ (0.49)	$ (7.61)
Weighted-average number of shares used in per share computation	98,239	88,848	96,426	88,710

See accompanying notes to consolidated condensed financial statements.

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MINDSPEED TECHNOLOGIES, INC.

Consolidated Condensed Statements of Cash Flows
(unaudited, in thousands)

	Six months ended March 31,	
	2004	**2003**
Cash flows from operating activities		
Net loss	$(47,566)	$(675,387)
Adjustments to reconcile net loss to net cash used in operating activities:		
Cumulative effect of change in accounting for goodwill		573,184
Depreciation	5,867	7,996
Amortization of intangible assets	25,107	26,522
Asset impairments		20,665
Provision for losses on accounts receivable	(108)	(273)
Inventory provisions	1,510	329
Other non-cash items, net	112	(8,264)
Changes in assets and liabilities:		
Receivables	(3,937)	822
Inventories	(7,260)	(1,622)
Accounts payable	(1,256)	(5,426)
Deferred revenue	1,711	(2,883)
Accrued expenses and other current liabilities	(2,911)	(5,644)
Other	440	1,027
Net cash used in operating activities	(28,291)	(68,954)
Cash flows from investing activities		
Capital expenditures	(3,123)	(2,372)
Sales of assets	54	9,211
Net cash provided by (used in) investing activities	(3,069)	6,839
Cash flows from financing activities		
Proceeds from exercise of options and warrants	10,939	
Deferred financing costs	(64)	
Net transfers and advances from Conexant		64,260

Net cash provided by financing activities	10,875	64,260
Net increase (decrease) in cash and cash equivalents	(20,485)	2,145
Cash and cash equivalents at beginning of period	80,121	7,269
Cash and cash equivalents at end of period	$ 59,636	$ 9,414

See accompanying notes to consolidated condensed financial statements.

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MINDSPEED TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation and Significant Accounting Policies

Mindspeed Technologies, Inc. (Mindspeed or the Company) designs, develops and sells semiconductor networking solutions for communications applications in enterprise, access, metropolitan and wide-area networks. On June 27, 2003, Conexant Systems, Inc. (Conexant) completed the distribution (the Distribution) to Conexant shareholders of all 90,333,445 outstanding shares of common stock of its wholly owned subsidiary, Mindspeed. In the Distribution, each Conexant shareholder received one share of Mindspeed 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 Mindspeed common stock. Following the Distribution, Mindspeed began operations as an independent, publicly held company.

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

Basis of Presentation

The consolidated condensed financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, include the accounts of Mindspeed and each of its subsidiaries. The consolidated condensed financial statements of Mindspeed for periods prior to the Distribution include the assets, liabilities, operating results and cash flows of the Mindspeed business, including subsidiaries, contributed to Mindspeed by Conexant. Such financial statements have been prepared using Conexant s historical bases in the assets and liabilities and the historical operating results of the Mindspeed business during each respective period. Management believes the assumptions underlying the consolidated condensed financial statements are reasonable. However, the financial information for periods prior to the Distribution may not reflect the consolidated financial position, operating results, changes in shareholders equity and cash flows of Mindspeed in the future or what they would have been had Mindspeed been a separate, stand-alone entity during the periods presented. All accounts and transactions among Mindspeed s entities have been eliminated in consolidation.

The consolidated condensed financial statements for periods prior to the Distribution include allocations of certain Conexant expenses (see Note 6). The expense allocations were determined using methods that Conexant and Mindspeed considered to be reasonable reflections of the utilization of services provided or the benefit received by Mindspeed. The allocation methods include specific identification, relative revenues or costs, or headcount. Management believes that the expenses allocated to Mindspeed are representative of the operating expenses it would have incurred had it operated on a stand-alone basis.

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 and the cumulative effect of the change in accounting for goodwill, 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 financial 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, 2003.

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

Fiscal Periods For presentation purposes, references made to the three months and six months ended March 31, 2004 and 2003 relate to the actual fiscal 2004 second quarter and six months ended April 2, 2004 and the actual fiscal 2003 second quarter and six months ended March 28, 2003, respectively.

Stock-Based Compensation - As permitted by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, the Company accounts for stock-based compensation under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under APB 25, the Company generally recognizes no compensation expense with respect to stock option awards. The following table illustrates the effect on net loss and net loss per share as if compensation expense for all awards of stock-based employee compensation had been determined under the fair value-based method prescribed by SFAS 123 (in thousands, except per share amounts).

	Three months ended March 31,		**Six months ended March 31,**	
	2004	**2003**	**2004**	**2003**
Net loss, as reported	$(21,346)	$(54,855)	$(47,566)	$(675,387)
Stock-based employee compensation expense determined under the fair value method	7,097	6,270	16,091	23,437
Pro forma net loss	$(28,443)	$(61,125)	$(63,657)	$(698,824)
Net loss per share, basic and diluted				
As reported	$ (0.22)	$ (0.62)	$ (0.49)	$ (7.61)
Pro forma	$ (0.29)	$ (0.69)	$ (0.66)	$ (7.88)

For purposes of the pro forma disclosures, compensation expense includes the estimated fair value of all stock-based compensation awarded to Mindspeed employees, including options to purchase Conexant common stock granted to Mindspeed employees prior to the Distribution. The fair value of each award is amortized to expense over its vesting period. The decrease in stock-based employee compensation expense determined under the fair value method for the six months ended March 31, 2004, compared with the similar fiscal 2003 period, reflects the higher fair values of awards made prior to the Distribution and the effect of many of those awards becoming vested.

Change in Accounting Principle - The Company adopted 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 initiated after June 30, 2001 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 $4.3 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 of SFAS 142, the Company ceased amortizing goodwill against its results of operations.

During fiscal 2003, the Company completed the transition impairment test of its goodwill (as of the beginning of fiscal 2003) required by SFAS 142. The Company consists of one reporting unit (as defined in SFAS 142) and for purposes of the impairment test, its fair value was determined considering both an income approach and a market approach. Management determined that the recorded value of goodwill exceeded its fair value (estimated to be zero) by $573.2 million. In the first quarter of fiscal 2003, the Company recorded a $573.2 million charge reflected in the accompanying statement of operations as the cumulative effect of a change in accounting principle to write down the value of goodwill to estimated fair value. The impaired goodwill comprises the unamortized balances of goodwill relating to Maker Communications, Inc., HotRail, Inc., Microcosm Communications Limited and Applied Telecom, Inc. Conexant acquired each of these businesses during fiscal 2000 for the Mindspeed business.

Supplemental Cash Flow Information - The Company paid no interest for the six months ended March 31, 2004 and 2003. Income taxes paid, net of refunds received, for the six months ended March 31, 2004 and 2003 were $(39,000) and $108,000, respectively.

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

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

2. Supplemental Financial Statement Data

Inventories

Inventories consist of the following (in thousands):

	March 31, 2004	September 30, 2003
Work-in-process	$5,644	$2,575
Finished goods	4,141	1,460
	$9,785	$4,035

Goodwill

During fiscal 2003, the Company completed the transition impairment test required by SFAS 142 and recorded a charge of $573.2 million to write down the carrying value of goodwill to its estimated fair value. Goodwill was adjusted as follows (in thousands):

Goodwill, September 30, 2002	$ 568,900
Assembled workforce reclassified to goodwill	4,284
Transition impairment loss	(573,184)
Goodwill, March 31, 2003	$

Intangible Assets

Intangible assets consist of the following (in thousands):

March 31, 2004	September 30, 2003

	Gross Asset	Accumulated Amortization	Gross Asset	Accumulated Amortization
Developed technology	$229,227	$(188,734)	$225,663	$(163,765)
Customer base	28,155	(23,204)	27,515	(19,911)
Other intangible assets	10,864	(10,629)	10,406	(10,041)
	$268,246	$(222,567)	$263,584	$(193,717)

The increases in the gross amounts of intangible assets as of March 31, 2004, as compared with September 30, 2003, reflect the impact of foreign currency translation adjustments. Intangible assets are amortized over a weighted-average period of approximately five years. Annual amortization expense by fiscal years is expected to be as follows (in thousands):

	2004	2005
Amortization expense	$50,361	$20,425

Comprehensive Loss

Comprehensive loss is as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2004	2003	2004	2003
Net loss	$(21,346)	$(54,855)	$(47,566)	$(675,387)
Foreign currency translation adjustments	227	(197)	965	96
Comprehensive loss	$(21,119)	$(55,052)	$(46,601)	$(675,291)

The balance of accumulated other comprehensive loss at March 31, 2004 and September 30, 2003 consists of accumulated foreign currency translation adjustments.

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

Revenues by Geographic Area

Revenues by geographic area, based upon country of destination, are as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2004	**2003**	**2004**	**2003**
Americas	$11,602	$ 9,168	$24,790	$21,474
Asia-Pacific	14,249	5,551	24,291	10,625
Europe, Middle East and Africa	4,899	3,592	8,415	6,467
	$30,750	$18,311	$57,496	$38,566

The Company believes a substantial portion of the products sold to original equipment manufacturers (OEMs) and third-party manufacturing service providers in the Asia-Pacific region are ultimately shipped to end-markets in the Americas and Europe. The following direct customers accounted for 10% or more of net revenues:

	Six months ended March 31,	
	2004	**2003**
Customer A	17%	24%
Customer B	12%	4%
Customer C	11%	5%

3. Guarantees

The Company has made guarantees and indemnities, under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions. In connection with the Distribution, the Company assumed responsibility for all contingent liabilities and then-current and future litigation against Conexant or its subsidiaries related to Mindspeed. The Company may also be responsible for certain federal income tax liabilities under the Tax Allocation Agreement between Mindspeed and Conexant, which provides that the Company will be responsible for certain taxes imposed on Mindspeed, Conexant or Conexant shareholders. In connection with the sales of its products, the Company provides intellectual property indemnities to its customers. In connection with certain facility leases, the Company has indemnified its lessors for certain claims arising from the facility or the lease. The

Company indemnifies its directors, officers, employees and agents to the maximum extent permitted under the laws of the State of Delaware. The duration of the guarantees and indemnities varies, and in many cases is indefinite. The guarantees and indemnities to customers in connection with product sales generally are subject to limits based upon the amount of the related product sales. The majority of other guarantees and indemnities do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. The Company has not recorded any liability for these guarantees and indemnities in the accompanying consolidated condensed balance sheets. Product warranty costs have not been significant.

4. Contingencies

Various lawsuits, claims and proceedings have been or may be instituted or asserted against the Company, including those pertaining to product liability, intellectual property, environmental, safety and health, and employment matters. In connection with the Distribution, Mindspeed assumed responsibility for all contingent liabilities and then-current and future litigation against Conexant or its subsidiaries to the extent such matters relate to the Mindspeed business.

The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to the Company. Many intellectual property disputes have a risk of injunctive relief and there can be no assurance that a license will be granted. Injunctive relief could have a material adverse effect on the financial condition or results of operations of the Company. Based on its evaluation of matters which are pending or asserted, management of the Company believes the disposition of such matters will not have a material adverse effect on the financial condition or results of operations of the Company.

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

5. Special Charges

Special charges consist of the following (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2004	2003	2004	2003
Asset impairments	$	$20,475	$	$20,665
Restructuring	387	3,971	387	7,612
Other special charges		(9,039)		(9,039)
	$387	$15,407	$387	$19,238

Asset Impairments

During the first six months of fiscal 2003, the Company recorded an impairment charge of $19.1 million to write down the carrying value of identified intangible assets (principally developed technology) related to the HotRail subsidiary. In January 2003, the Company decided to close the HotRail design center and to curtail investment in selected associated products. Management evaluated the recoverability of the assets of the HotRail business to determine whether their value was impaired, based upon the future cash flows expected to be generated by the affected products over the remainder of their life cycles (estimated to be approximately five years). The estimated sales volumes, pricing, gross margin and operating expenses were consistent with historical trends and other available information. Since the estimated undiscounted cash flows were less than the carrying value (approximately $27.4 million) of the related assets, management determined that the value of such assets was impaired. The Company recorded an impairment charge of $19.1 million, which was determined by comparing the estimated fair value of the assets to their carrying value. The fair value of the assets was determined by computing the present value of the expected future cash flows using a discount rate of 18%, which management believes is commensurate with the underlying risks associated with the projected cash flows. Management believes the assumptions used in the discounted cash flow model represent a reasonable estimate of the fair value of the assets. The write-down established a new cost basis for the impaired assets.

Also during the first six months of fiscal 2003, the Company recorded asset impairment charges totaling $1.6 million related to certain assets that it determined to abandon or scrap.

Restructuring Charges

In fiscal 2001, 2002 and 2003, the Company implemented a number of cost reduction initiatives to improve its operating cost structure. The cost reduction initiatives included workforce reductions, significant reductions in capital spending, the consolidation of certain facilities and salary reductions for the senior management team until the Company returns to profitability. The costs and expenses associated with the restructuring activities are included in special charges in the accompanying consolidated condensed statements of operations.

Mindspeed Strategic Restructuring Plan During the third quarter of fiscal 2002, the Company announced a number of expense reduction and restructuring initiatives intended to reduce further its operating cost structure and focus its research and development spending on products for the network infrastructure market segments it believes offer the most attractive near-term growth prospects. These actions include the elimination of research and development spending in high-end optical networking applications, the closure of Novanet Semiconductor Ltd., the divestiture of NetPlane Systems, Inc. and a reduction of support services spending, in total reducing the Company s workforce by over 400 employees. During fiscal 2002, the Company terminated approximately 280 of such employees and recorded charges aggregating $7.1 million. These charges were based upon estimates of the cost of severance benefits for the affected employees. These actions reduced the Company s workforce throughout its operations. In addition, the Company recorded restructuring charges of $16.1 million for costs associated with the consolidation of certain facilities, including lease cancellation and related costs.

During the first quarter of fiscal 2003, the Company implemented an additional workforce reduction affecting approximately 80 employees and closed its design center in Bristol, England. The Company recorded additional charges of $2.3 million for the workforce reductions, based upon estimates of the cost of severance benefits for the

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

affected employees, and $4.6 million for commitments under facility leases and license obligations for the purchase of design tools that the Company determined would not be used in the future. During the first quarter of fiscal 2003, the Company substantially completed these workforce reductions. Activity and liability balances related to the Mindspeed strategic restructuring plan through March 31, 2004 are as follows (in thousands):

	Workforce Reductions	Facility and Other	Total
Charged to costs and expenses	$ 7,061	$16,109	$ 23,170
Cash payments	(2,419)	(1,211)	(3,630)
Non-cash charges	(552)	(354)	(906)
Restructuring balance, September 30, 2002	4,090	14,544	18,634
Charged to costs and expenses	2,341	4,589	6,930
Cash payments	(6,431)	(9,980)	(16,411)
Restructuring balance, September 30, 2003		9,153	9,153
Expense reversal		(38)	(38)
Cash payments		(4,551)	(4,551)
Restructuring balance, March 31, 2004	$	$ 4,564	$ 4,564

Mindspeed 2003 Restructuring Plan In March 2003, the Company announced a number of expense reduction and restructuring initiatives intended to further improve its operating cost structure. The actions include the closure of the HotRail design center in San Jose, California and a further workforce reduction of approximately 130 employees. Restructuring charges for this plan include an aggregate of $4.8 million of severance benefits paid to the affected employees. In addition, restructuring charges for this plan also include $1.3 million for costs associated with the consolidation of certain facilities and lease cancellation and related costs. Activity and liability balances related to the Mindspeed 2003 restructuring plan through March 31, 2004 are as follows (in thousands):

	Workforce Reductions	Facility and Other	Total

Charged to costs and expenses	$ 4,077	$ 1,568	$ 5,645
Cash payments	(3,759)	(191)	(3,950)
Restructuring balance, September 30, 2003	318	1,377	1,695
Charged to costs and expenses	689	(264)	425
Cash payments	(636)	(329)	(965)
Restructuring balance, March 31, 2004	$ 371	$ 784	$ 1,155

Other Restructuring Plans All restructuring charges and payments relating to cost reduction actions under the Company s other restructuring plans were completed prior to September 30, 2003. During the first six months of fiscal 2003, the Company reversed $0.3 million of previously accrued costs upon the resolution of its liabilities for severance benefits and lease costs payable under these plans.

Through March 31, 2004, the Company paid an aggregate of $34.1 million in connection with its restructuring plans and has a remaining accrued restructuring balance totaling $5.7 million (including $2.6 million classified as a long-term liability in the accompanying consolidated condensed balance sheet). The Company expects to pay the amounts accrued for the workforce reductions during fiscal 2004 and expects to pay the obligations for the non-cancelable lease and other contractual commitments over their respective terms, which expire at various dates through fiscal 2008. Cash payments to complete the restructuring actions will be funded from available cash balances and funds from product sales, and are not expected to impact significantly the Company s liquidity.

Other Special Charges

Other special charges for the second quarter and first six months of fiscal 2003 principally consist of a $9.0 million gain on the sale of the assets of NetPlane.

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MINDSPEED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(unaudited)

6. Related Party Transactions

Prior to the Distribution, the Company operated as a wholly owned subsidiary of Conexant. Conexant maintained a centralized treasury function and provided funding for Mindspeed s working capital and capital expenditure requirements. This funding consisted of Conexant s payment of expenses allocated to Mindspeed and payments made by Conexant on behalf of Mindspeed. The financing from Conexant was in the form of equity capital advances to Mindspeed with no formal repayment or interest arrangements. The equity capital advances were recorded as additions to Conexant s net investment in the consolidated condensed balance sheets. A summary of the accumulated net transfers from Conexant and the average balances outstanding are as follows (in thousands):

	Six months ended March 31, 2003
Balance at beginning of period	$470,056
Cash collected by Conexant on behalf of Mindspeed	(39,115)
Purchases from Conexant	25
Capital expenditures	2,372
Expenses allocated from Conexant	4,947
Amounts paid by Conexant on behalf of Mindspeed	95,998
Net transfers from Conexant	64,227
Balance at end of period	$534,283
Average balance	$502,170

Expenses allocated from Conexant included in the accompanying consolidated condensed statements of operations (principally representing services provided by Conexant and facility rent) are as follows (in thousands):

	Six months ended March 31, 2003

Cost of goods sold	$ 348
Research and development	2,269
Selling and marketing	12
General and administrative	2,318
	$4,947

Following the Distribution, Mindspeed and Conexant each provide certain services to the other under the Transition Services Agreement. Mindspeed also leases its headquarters and principal design center in Newport Beach, California from Conexant under the Sublease. The cost of such services and rent totaled $2.5 million for the six months ended March 31, 2004.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This information should be read in conjunction with our unaudited consolidated condensed financial statements and the notes thereto included in this Quarterly Report and our audited consolidated financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for our fiscal year ended September 30, 2003.

Overview

We design, develop and sell 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 classified into four focused product families: high-performance analog products, multiservice access products, T/E carrier products and asynchronous transfer mode (ATM)/multi-protocol label switching (MPLS) network processor products. Our products 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, that support the processing, transmission and switching of high-speed voice and data traffic within different segments of the communications network.

We market and sell our semiconductor products and system 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. Sales to distributors accounted for approximately 58% and 52% of our revenues for fiscal 2003 and the first six months of fiscal 2004, respectively. For fiscal 2003, distributors Avnet, Inc. and Alltek Technology Corporation accounted for 22% and 12% of our net revenues; for the first six months of fiscal 2004, distributors Avnet and RTI Industries Company Ltd. and OEM Cisco Systems, Inc. accounted for 17%, 11% and 12%, respectively, of our net revenues. No other direct customer accounted for 10% or more of our net revenues for these periods. Including indirect sales, we believe that Cisco Systems, Inc. accounted for approximately 15% and 20% of our net revenues for fiscal 2003 and the first six months of fiscal 2004, respectively, and that no other OEM customer accounted for 10% or more of our net revenues for these periods. Sales to customers located outside the United States, primarily in the Asia-Pacific region and Europe, represented approximately 60% and 69%, respectively, of our net revenues for fiscal 2003 and the first six months of fiscal 2004. We believe a substantial portion of the products we sell to OEMs and third-party manufacturing service providers in the Asia-Pacific region are ultimately shipped to end markets in the Americas and Europe.

Spin-off from Conexant Systems, Inc.

On June 27, 2003, 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 trades on the Nasdaq National Market System 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. In the event we make borrowings under the credit facility, Conexant will be entitled to exercise warrants to purchase a number of shares of our common stock, increasing on a pro rata basis up to approximately 8.3 million shares if the level of borrowings under the credit facility reaches $50 million, at an exercise price based on the lower of the fair market value of our common stock at the time of the Distribution or the time of the borrowing. We also 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 entered into Registration

Rights Agreements with Conexant under which we registered with the Securities and Exchange Commission the sale of the warrants and the underlying shares of our common stock. In connection with the Distribution, we and Conexant also entered into an Employee Matters Agreement, a Tax Allocation Agreement, a Transition Services Agreement and a Sublease.

Results of Operations

Net Revenues

We recognize revenues from product sales upon shipment and transfer of title, in accordance with the shipping terms specified in the arrangement with the customer. Revenue recognition is deferred in all instances where the earnings process is incomplete. We sell a portion of our products to electronic component distributors under agreements allowing for a right to return unsold products. We defer the recognition of revenue on all sales to these distributors until the products are sold by the distributors to a third party. We record a reserve for sales returns and allowances for other customers based on historical experience or specific identification of an event necessitating a reserve. Development revenue is recognized when services are performed and was not significant for any of the periods presented. The following table summarizes our net revenues:

	Three months ended March 31,			Six months ended March 31,		
($ in millions)	2004	Change	2003	2004	Change	2003
Net revenues	$30.8	68%	$18.3	$57.5	49%	$38.6

For the first six months of fiscal 2004, the increase in our revenues compared to the similar fiscal 2003 period principally reflects higher sales volumes in our multiservice access processor, ATM/MPLS network processor and T/E carrier product families. In particular, we experienced sharply increased demand for our multiservice access voice-over-IP solutions used in carrier infrastructure applications. We also saw continued strong demand for our ATM/MPLS network processor products for use in wireless, enterprise and broadband infrastructure applications. Our T/E carrier products benefited from higher demand for our DS3/E3 products for use in next-generation optical networking equipment designed to increase the capacity, flexibility and speed of metropolitan area networks. We also experienced modestly higher sales volumes in our high-performance analog products. These increases were partially offset by lower shipments of our digital subscriber line (DSL) transceivers and the effect of our divestiture of the NetPlane Systems, Inc. software business in January 2003.

The increase in our revenues for the second quarter of fiscal 2004 compared to the similar fiscal 2003 period principally reflects higher sales volumes in our multiservice access processor products as a result of sharply increased demand for our multiservice access voice-over-IP solutions used in carrier infrastructure applications. Sales volumes were also higher in our ATM/MPLS network processor and our T/E carrier product families. These increases were partially offset by lower sales volume in our high-performance analog products, principally in our crosspoint switches for use in storage applications.

Gross Margin

($ in millions)	Three months ended March 31,			Six months ended March 31,		
	2004	Change	2003	2004	Change	2003
Gross margin	$22.9	81%	$12.7	$41.5	55%	$26.8
Percent of net revenues	74%		69%	72%		69%

Gross margin represents revenues less cost of goods sold. As a fabless semiconductor company, we use third parties for wafer fabrication and assembly and test services. Our cost of goods sold consists predominantly of: purchased finished wafers; assembly and test services; royalty and other intellectual property costs; labor and overhead costs associated with product procurement; and sustaining engineering expenses pertaining to products sold.

Our gross margin for the first six months of fiscal 2004 compared to the similar fiscal 2003 period reflects the 49% increase in revenues and the favorable impact of the cost reduction actions we took during fiscal 2003. For the first six months of fiscal 2004 and 2003, our gross margin also benefited from the sale of inventories with an original cost of $3.8 million and $2.6 million, respectively, that we had written down to a zero cost basis during fiscal 2001. These sales resulted from renewed demand for certain products that was not anticipated at the time of the write-downs. The previously written-down inventories were generally sold at prices which exceeded their original cost. Had we not previously written down the cost basis of these goods, our gross margin for the first six months of fiscal 2004 would have been $37.7 million (66% of our net revenues) compared to $24.2 million (63% of our net revenues) for the first six months of fiscal 2003.

For the second quarter of fiscal 2004 and 2003, our gross margin benefited from the sale of inventories with an original cost of $2.8 million and $1.1 million, respectively, that we had written down to a zero cost basis during fiscal year 2001. Had we not previously written down the cost basis of these goods, our gross margin for the second quarter of fiscal 2004 would have been $20.1 million (65% of our net revenues) compared to $11.6 million (63% of our net revenues) for the fiscal 2003 second quarter.

In fiscal 2001, we recorded an aggregate of $83.5 million of inventory write-downs, reducing the cost basis of the affected inventories to zero. The fiscal 2001 inventory write-downs resulted from the sharply reduced end-customer demand for network infrastructure equipment during that period. As a result of these market conditions, we experienced a significant number of order cancellations and a decline in the volume of new orders beginning in the fiscal 2001 first quarter. Our fiscal 2001 second quarter revenues decreased 51% compared with the immediately preceding quarter. The reduced global demand for our products became more pronounced in the third and fourth quarters of fiscal 2001, and we experienced further sequential decreases in our quarterly revenues of 56% and 39%, respectively, in those periods. As a result of our ongoing assessment of the recoverability of our inventories, we recorded inventory write-downs of $10.9 million, $51.7 million and $20.9 million in the first, second and third quarters of fiscal 2001, respectively. The inventories written down in fiscal 2001 principally consisted of multiservice access processors and DSL transceivers.

We assess the recoverability of our inventories at least quarterly through a review of inventory levels in relation to foreseeable demand (generally over six months). Foreseeable demand is based upon all available information, including sales backlog and forecasts, product marketing plans and product life cycles. When the inventory on hand exceeds the foreseeable demand, we write down the value of those inventories which, at the time of our review, we expect to be unable to sell. The amount of the inventory write-down is the excess of historical cost over estimated realizable value. Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory.

Our products are used by OEMs that have designed our products into network infrastructure equipment. For many of our products, we gain these design wins through a lengthy sales cycle, which often includes providing technical support to the OEM customer. In the event of the loss of business from existing OEM customers, we may be unable to secure new customers for our existing products without first achieving new design wins. When the quantities of inventory on hand exceed foreseeable demand from existing OEM customers into whose products our products have been designed, we generally will be unable to sell our excess inventories to others, and the estimated realizable value of such inventories to us is generally zero.

From the time of the fiscal 2001 inventory write-downs through March 31, 2004, we scrapped a portion of these inventories having an original cost of $34.3 million and sold a portion of these inventories with an original cost of $12.6 million. The sales resulted from increased demand beginning in the first quarter of fiscal 2002 which was not anticipated at the time of the write-downs. As of March 31, 2004, we continued to hold inventories with an original cost of $36.6 million which were previously written down to a zero cost basis. We currently intend to hold these remaining inventories and will sell these inventories if we experience renewed demand for these products. While there can be no assurance that we will be able to do so, if we are able to sell a portion of the inventories which are carried at zero cost basis, our gross margins will be favorably affected by an amount equal to the original cost of the zero-cost basis inventory sold. To the extent that we do not experience renewed demand for the remaining inventories, they will be scrapped as they become obsolete.

We base our assessment of the recoverability of our inventories, and the amounts of any write-downs, on currently available information and assumptions about future demand and market conditions. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand is lower than originally projected, additional inventory write-downs may be required.

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Research and Development

($ in millions)	Three months ended March 31, 2004	Change	2003	Six months ended March 31, 2004	Change	2003
Research and development	$20.1	(23)%	$26.2	$40.5	(29)%	$57.3
Percent of net revenues	65%		143%	71%		149%

Our research and development (R&D) expenses consist principally of direct personnel costs, electronic design automation tools, photomask development and pre-production evaluation and test costs. During fiscal 2003, we closed design centers in San Jose, California and Bristol, United Kingdom and we completed the divestiture of our NetPlane Systems business. The decrease in R&D expenses for the second quarter and first six months of fiscal 2004 compared to the similar fiscal 2003 periods primarily reflects lower headcount and personnel-related costs resulting from these expense reduction actions.

Selling, General and Administrative

($ in millions)	Three months ended March 31, 2004	Change	2003	Six months ended March 31, 2004	Change	2003
Selling, general and administrative	$10.9	(18)%	$13.3	$22.9	(10)%	$25.5
Percent of net revenues	35%		73%	40%		66%

Our selling, general and administrative (SG&A) expenses include personnel costs, independent sales representative commissions and product marketing, applications engineering and other marketing costs. Our SG&A expenses also include costs of corporate functions including accounting, finance, legal, human resources, information systems and communications. Our SG&A expenses for the second quarter and first six months of fiscal 2004 compared to the similar fiscal 2003 periods reflect the positive impact of lower headcount and personnel-related costs resulting from our expense reduction and restructuring actions, partially offset by increased selling costs and public company costs.

Amortization of Intangible Assets

($ in millions)	Three months ended March 31, 2004	Change	2003	Six months ended March 31, 2004	Change	2003
Amortization of intangible assets	$12.6	3%	$12.3	$25.1	(5)%	$26.5
Percent of net revenues	41%		67%	44%		69%

The increase in amortization of intangible assets for the second quarter of fiscal 2004 compared to the similar fiscal 2003 period resulted from fluctuations in foreign currency exchange rates. The lower amortization expenses in the first six months of fiscal 2004 compared to the similar fiscal 2003 period principally reflects the lower balance of intangible assets in the fiscal 2004 period. During the second quarter of fiscal 2003, we recorded an impairment charge of $19.1 million to write down the carrying value of identified intangible assets (principally developed technology) related to our HotRail, Inc. subsidiary. We expect that amortization of intangible assets will total approximately $50.4 million for fiscal 2004.

Special Charges

Special charges consist of the following:

	Three months ended March 31,			Six months ended March 31,		
($ in millions)	**2004**	**Change**	**2003**	**2004**	**Change**	**2003**
Asset impairments	$	nm	$ 20.5	$	nm	$ 20.7
Restructuring charges	0.4	nm	4.0	0.4	nm	7.6
Other special charges		nm	(9.1)		nm	(9.1)
	$ 0.4	nm	$ 15.4	$ 0.4	nm	$ 19.2

nm = not meaningful

Asset Impairments

For a discussion of our asset impairment charges, see Note 5 of Notes to Consolidated Condensed Financial Statements.

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We continually monitor and review long-lived assets, including fixed assets, goodwill and intangible assets, for possible impairment. Future impairment tests may result in significant write-downs of the value of our assets.

Restructuring Charges

Commencing in fiscal 2001, and continuing into fiscal 2003, we implemented a number of cost reduction initiatives to improve our operating cost structure. For a discussion of our cost reduction initiatives and activity under our restructuring plans, see Note 5 of Notes to Consolidated Condensed Financial Statements.

As of March 31, 2004, the cost reduction actions under our restructuring plans are substantially complete. Through March 31, 2004, we have paid an aggregate of $34.1 million in connection with our fiscal 2001, 2002 and 2003 restructuring plans and we have an aggregate remaining accrued restructuring balance of $5.7 million. We expect to pay the amounts accrued for the workforce reductions during fiscal 2004 and we expect to pay the obligations for the non-cancelable leases and other contractual commitments over their respective terms, which expire at various dates through fiscal 2008. Cash payments to complete the restructuring actions will be funded from available cash balances and funds from product sales, and are not expected to impact significantly our liquidity.

Other Special Charges

Other special charges for the second quarter and first six months of fiscal 2003 principally consist of a $9.0 million gain on the sale of the assets of NetPlane.

Other Income (Expense), Net

	Three months ended March 31,			Six months ended March 31,		
($ in millions)	**2004**	**Change**	**2003**	**2004**	**Change**	**2003**
Other income (expense), net	$0.1	nm	$(0.1)	$0.3	nm	$(0.2)
Percent of net revenues	%		(1)%	1%		%

Other income (expense), net principally consists of interest income, foreign exchange gains and losses and other non-operating gains and losses. The increase in other income (expense) for the second quarter and first six months of fiscal 2004 compared to the similar fiscal 2003 periods principally reflects higher interest income resulting from larger invested cash balances.

Provision for Income Taxes

Our provision for income taxes for the second quarter and first six months of fiscal 2004 and 2003 principally consisted of income taxes incurred by our foreign subsidiaries. As a result of our recent operating losses and our expectation of future operating results, we determined that it is more likely than not that the additional income tax benefits (principally net operating losses we can carry forward to future years) which arose during fiscal 2003 and the first six months of fiscal 2004 will not be realized. Accordingly, we have not recognized any income tax benefits relating to our operating losses for those periods and we do not expect to recognize any income tax benefits relating to future operating losses until we believe that such tax benefits are more likely than not to be realized. We expect that our provision for income taxes for fiscal 2004 will principally consist of income taxes related to our foreign operations.

Change in Accounting for Goodwill

We adopted SFAS No. 142, Goodwill and Other Intangible Assets, as of the beginning of fiscal 2003. Upon adoption of SFAS 142, we completed the required transition impairment test of our goodwill (as of the beginning of fiscal 2003). Our business consists of one reporting unit (as defined in SFAS 142) and for purposes of the impairment test, we determined its fair value considering both an income approach and a market approach. Management determined that the recorded value of goodwill exceeded its fair value (estimated to be zero) by $573.2 million. In the first quarter of fiscal 2003, we recorded a $573.2 million charge reflected in the accompanying statement of operations as the cumulative effect of a change in accounting principle to write down the value of goodwill to estimated fair value. The impaired goodwill comprises the unamortized balances of goodwill relating to Maker Communications, Inc., HotRail, Inc., Microcosm Communications Limited and Applied Telecom, Inc. Conexant acquired each of these businesses during fiscal 2000 for our business. The impairment charge resulted from the sharp decline in the valuations assigned to communications semiconductor companies as of the time of the transition impairment test as compared with valuations at the dates of the respective acquisitions.

Liquidity and Capital Resources

Cash used in operating activities was $28.3 million for the first six months of fiscal 2004 compared to $69.0 million for the first six months of fiscal 2003. Operating cash flows for the first six months of fiscal 2004 reflect our net loss of $47.6 million, partially offset by non-cash charges (depreciation and amortization, special charges and other) of $32.5 million, and net working capital increases of approximately $13.2 million. Before the effect of working capital changes, cash used in operations was $15.1 million for the first six months of fiscal 2004, compared to $55.2 million for the first six months of fiscal 2003.

The net working capital increases for the first six months of fiscal 2004 consist principally of a $7.3 million increase in inventories resulting from our decision to increase inventory levels to satisfy anticipated customer demand. The net working capital increases also include a $3.9 million increase in accounts receivable due to higher quarterly sales and a $4.2 million decrease in accounts payable, accrued expenses and other current liabilities, principally related to the timing of vendor payments and the payment of restructuring costs. These working capital increases were partially offset by a $1.7 million increase in deferred revenues resulting from higher levels of inventory held by certain of our distributor customers.

Cash used in investing activities for the first six months of fiscal 2004 consisted of capital expenditures of $3.1 million, including $0.8 million representing the cost of photomask sets for new products. These amounts were partially offset by proceeds from sales of assets of $0.1 million. Cash provided by investing activities for the first six months of fiscal 2003 consisted of proceeds from sales of assets of $9.2 million, partially offset by capital expenditures of $2.4 million.

Cash provided by financing activities for the first six months of fiscal 2004 consisted of proceeds of $10.9 million from the exercise of stock options and warrants, partially offset by costs paid in connection with the credit facility with Conexant. Cash provided by financing activities for the first six months of fiscal 2003 consisted of net transfers from Conexant of $64.3 million for working capital purposes.

In connection with the Distribution, we entered into a Credit Agreement with Conexant, under which we may borrow up to $50 million for working capital and other general corporate purposes. The credit facility is available for a term ending on June 29, 2007. We may borrow under the credit facility only to restore our cash balance to $25 million. Loans under the credit facility will accrue interest at the rate of 10 percent per annum, payable at maturity. The credit facility contains customary conditions and covenants, including restrictions on payment of dividends, consolidations, mergers, acquisitions, investments, sales of assets, incurrence of indebtedness and creation of liens and encumbrances. In the event that we make borrowings under the credit facility, Conexant will be entitled to exercise warrants to purchase a number of shares of our common stock, increasing on a pro rata basis up to approximately 8.3 million shares if the level of borrowings under the credit facility reaches $50 million, at an exercise price based on the lower of the fair market value of our common stock at the time of the Distribution or the time of the borrowing. As of March 31, 2004, we had made no borrowings under the credit facility.

During the past three fiscal years, we reduced our capital expenditures and implemented a number of expense reduction initiatives to improve our operating cost structure. These expense reduction initiatives, together with the revenue growth we experienced over the past four quarters, have significantly reduced our operating losses and our net cash burn (the sum of our net cash used in operating activities and net cash used in investing activities) compared to fiscal 2002 and 2003 levels. For the second quarter of fiscal 2004, our net cash burn was $13.8 million compared to $41.5 million in the fiscal 2003 first quarter. However, in order to return to profitability or to generate positive cash flows from our operations we must achieve significant additional revenue growth, and we expect to continue to incur significant operating losses in the near term.

Our principal sources of liquidity are our existing cash balances, cash generated from product sales and available borrowings under the $50 million credit facility with Conexant. Our cash and cash equivalents at March 31, 2004 totaled $59.6 million and our working capital at March 31, 2004 was $63.6 million.

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We believe that our existing sources of liquidity 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. We will need to continue a focused program of capital expenditures to launch anticipated new products and to meet our research and development and corporate requirements. We may also consider acquisition opportunities to extend our technology portfolio and design expertise and to expand our product offerings. In order to fund capital expenditures, increase our working capital or complete any acquisitions, we may seek to obtain additional financing by issuing debt, equity or equity-based securities, including additional shares of our common stock. However, we cannot assure you that such financing will be available to us on favorable terms, or at all.

Contractual Obligations

We lease our facilities and certain equipment under non-cancelable operating leases, including the Sublease with Conexant. The leases expire at various dates through fiscal 2008 and contain various provisions for rental adjustments including, in certain cases, adjustments based on increases in the Consumer Price Index. Rent payable under the Sublease is a prorated portion of Conexant s actual costs. The leases generally contain renewal provisions for varying periods of time. As of March 31, 2004, we had no long-term debt, capital lease obligations or long-term purchase obligations. The following table summarizes the future payments we are required to make under contractual obligations as of March 31, 2004:

	Payments due by period				
Contractual Obligations	**Total**	**<1 year**	**1-3 years**	**3-5 years**	**>5 years**
			(in millions)		
Operating leases	$29.1	$8.6	$13.8	$6.7	$

Off-Balance Sheet Arrangements

We have made guarantees and indemnities, under which we may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions. In connection with the Distribution, we generally assumed responsibility for all contingent liabilities and then-current and future litigation against Conexant or its subsidiaries related to the Mindspeed business. We may also be responsible for certain federal income tax liabilities under the Tax Allocation Agreement between us and Conexant, which provides that we will be responsible for certain taxes imposed on us, Conexant or Conexant shareholders. In connection with certain facility leases, we have indemnified our lessors for certain claims arising from the facility or the lease. We indemnify our directors, officers, employees and agents to the maximum extent permitted under the laws of the State of Delaware. The duration of the guarantees and indemnities varies, and in many cases is indefinite. The majority of our guarantees and indemnities do not provide for any limitation of the maximum potential future payments we could be obligated to make. We have not recorded any liability for these guarantees and indemnities in the accompanying consolidated balance sheets.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The critical accounting policies used in preparation of our financial statements are described under Management s Discussion and Analysis of Financial Condition and Results of

Operations Critical Accounting Policies on pages 30-31 of our Annual Report on Form 10-K for the year ended September 30, 2003. There have been no significant changes in our critical accounting policies during the six months ended March 31, 2004.

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.

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

We incurred a net loss of $47.6 million in the first six months of fiscal 2004 compared to a net loss of $675.3 million ($102.2 million, before the $573.2 million cumulative effect of a change in accounting for goodwill) in the first six months of fiscal 2003. We incurred net losses of $750.4 million in fiscal 2003 and $668.3 million in fiscal 2002. We expect that we will continue to incur significant operating losses in the near term.

In order to return to profitability or to generate positive cash flows from our operations we must achieve significant additional revenue growth. This additional revenue growth will depend on a further renewal in demand for network infrastructure equipment that incorporates our products, which in turn depends primarily on capital spending levels of communications service providers. Although our expense reduction and restructuring initiatives have significantly reduced our operating costs, expense reductions alone, without additional 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 first six months of fiscal 2004, our net cash burn (the sum of our net cash used in operating activities and net cash used in investing activities) was $31.4 million. For fiscal 2003, our net cash burn was $119.6 million. 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 balances (approximately $59.6 million as of March 31, 2004), cash generated from product sales and available borrowings under a $50 million credit facility with Conexant. We believe that our existing sources of liquidity 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. During fiscal 2001 and 2002, we like many of our customers and competitors experienced an abrupt decline in demand for many of the end-user products that incorporate our products. The impact of weakened end-customer demand was compounded by higher than normal levels of equipment and component inventories held by many of our OEM, subcontractor and distributor customers. These conditions represented the worst downturn in the history of the semiconductor industry, and the market for communications semiconductor products was impacted more adversely than the industry as a whole. Although we have recently experienced renewed demand for a number of our products, overall demand remains significantly lower than historic levels. We cannot assure you as to whether or when market conditions will improve to the extent necessary for us to return to profitability.

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 Taiwan Semiconductor Manufacturing Co., Ltd. and Jazz Semiconductor, Inc. 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 Technology, Inc., 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.

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.

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 the 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. These 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 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% and 52% of our net revenues for fiscal 2003 and the first six months of fiscal 2004, respectively. We routinely purchase inventory based on estimates of end-market demand for our customers products, which may be subject to dramatic changes and 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. In fiscal 2001 we recorded $83.5 million of inventory write-downs as a result of the sharply reduced end-customer demand for our products during that period.

We are subject to the risks of doing business internationally.

For fiscal 2003 and the first six months of fiscal 2004, approximately 60% and 69%, respectively, 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 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;
- 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 Quarterly 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 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.

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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 System 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 research coverage of our common stock;

changes in earnings estimates or buy/sell recommendations by analysts;

general financial and other market conditions; and

domestic and international economic conditions.

In addition, public stock markets have experienced, and may in the future experience, extreme price and trading volume volatility, particularly in the technology sectors of the market. This volatility has significantly affected the market prices of securities of many technology companies for reasons frequently unrelated to or disproportionately impacted by the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our common stock.

Substantial sales of the shares of our common stock issuable upon exercise of the warrants issued to Conexant, or of the warrants themselves, could also depress our stock price or adversely affect our ability to raise additional financing in the public capital markets.

Conexant holds warrants to acquire 30 million shares of our common stock, exercisable on or after June 27, 2004, representing approximately 20 percent of our outstanding common stock on a fully diluted basis. Conexant also holds warrants to acquire up to approximately 8.3 million shares of our common stock, some or all of which will become exercisable in the event we borrow under the credit facility provided by Conexant. When the warrants become exercisable the underlying shares of our common stock may be acquired and sold. Moreover, the warrants may be transferred or sold at any time. If Conexant sells the warrants or if Conexant or a transferee of the warrants exercises the warrants and sells a substantial number of shares of our common stock in the future, or if investors perceive that these sales may occur, the market price of our common stock could decline or market demand for our common stock could be sharply reduced and our ability to raise additional financing by issuing equity or equity-based securities in the public capital markets could be adversely affected.

Some of our directors and executive officers may have potential conflicts of interest because of their positions with Conexant or their ownership of Conexant common stock.

Some of our directors are Conexant directors, and our non-executive chairman of the board is chairman of the board and the former chief executive officer of Conexant. Several of our directors and executive officers own Conexant common stock and hold options to purchase Conexant common stock. Service as both a director of ours and as a director or officer of Conexant, or ownership of Conexant common stock by our directors and executive officers, could create, or appear to create, potential conflicts of interest when directors and officers are faced with decisions that could have different implications for us and Conexant. For example, potential conflicts could arise in connection with decisions involving the credit facility provided to us by Conexant or the warrants to purchase our

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common stock issued to Conexant, or under the other agreements entered into between us and Conexant in connection with the Distribution.

Our restated certificate of incorporation includes provisions relating to the allocation of business opportunities that may be suitable for both us and Conexant based on the relationship to the companies of the individual to whom the opportunity is presented and the method by which it was presented and also includes provisions limiting challenges to the enforceability of contracts between us and Conexant.

We may have difficulty resolving any potential conflicts of interest with Conexant, and even if we do, the resolution may be less favorable than if we were dealing with an entirely unrelated third party.

Provisions in our organizational documents and rights plan and Delaware law will make it more difficult for someone to acquire control of us.

Our restated certificate of incorporation, our amended bylaws, our rights agreement and the Delaware General Corporation Law contain several provisions that would make more difficult an acquisition of control of us in a transaction not approved by our board of directors. Our restated certificate of incorporation and amended bylaws include provisions such as:

- the division of our board of directors into three classes to be elected on a staggered basis, one class each year;
- the ability of our board of directors to issue shares of our preferred stock in one or more series without further authorization of our shareholders;
- a prohibition on shareholder action by written consent;
- a requirement that shareholders provide advance notice of any shareholder nominations of directors or any proposal of new business to be considered at any meeting of shareholders;
- a requirement that a supermajority vote be obtained to remove a director for cause or to amend or repeal certain provisions of our restated certificate of incorporation or amended bylaws;
- elimination of the right of shareholders to call a special meeting of shareholders; and
- a fair price provision.

Our rights agreement gives our shareholders certain rights that would substantially increase the cost of acquiring us in a transaction not approved by our board of directors.

In addition to the rights agreement and the provisions in our restated certificate of incorporation and amended bylaws, Section 203 of the Delaware General Corporation Law generally provides that a corporation shall not engage in any business combination with any interested shareholder during the three-year period following the time that such shareholder becomes an interested shareholder, unless a majority of the directors then in office approves either the business combination or the transaction that results in the shareholder becoming an interested shareholder or specified shareholder approval requirements are met.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Consequently, we invest in the securities of high-credit-quality issuers and limit the amount of our credit exposure to any one issuer. We do not use derivative instruments for speculative or investment purposes.

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of March 31, 2004, the carrying value of our cash and cash equivalents approximates fair value.

We transact business in various foreign currencies, and we have established a foreign currency hedging program utilizing foreign currency forward exchange contracts to hedge certain foreign currency transaction exposures. Under this program, we seek to offset foreign currency transaction gains and losses with gains and losses on the forward contracts, so as to mitigate our overall risk of foreign currency transaction gains and losses. We do not enter into forward contracts for speculative or trading purposes. At March 31, 2004, we held no foreign currency forward exchange contracts. Based on our overall currency rate exposure at March 31, 2004, a 10 percent change in currency rates would not have a material effect on our consolidated financial position, results of operations or cash flows.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and its Chief Financial Officer, the Company carried out an evaluation of the effectiveness as of March 31, 2004 of the design and operation of its disclosure controls and procedures, which are defined under Securities and Exchange Commission rules as controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Based upon that evaluation, the Company s Chief Executive Officer and its Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report to timely alert them to material information relating to the Company required to be included in the Company s Exchange Act filings. There were no changes in the Company s internal control over financial reporting during the fiscal quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Our annual meeting of shareholders was held on February 26, 2004 in Irvine, California. At the meeting, the following matters were voted on by our shareholders and approved by the following votes:`

	Number of shares	
	Voted For	Withheld
Election of directors:		
Donald R. Beall	70,554,855	15,336,133
Jerre Stead	81,588,565	4,302,423

	Number of shares		
	Voted For	Voted Against	Abstentions
Proposal to ratify the appointment of Deloitte & Touche LLP as our independent auditors	85,002,316	630,288	258,384

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

3.1 Bylaws of the Company, as amended.

3.2 Amendment to the Bylaws of the Company adopted by the Board of Directors of the Company on May 6, 2004.

31.1 Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Current Report on Form 8-K dated January 28, 2004, furnishing the Company s press release dated January 28, 2004, announcing its financial results for the quarter ended December 31, 2003. (Item 12)

Current Report on Form 8-K dated April 19, 2004, furnishing the Company s press release dated April 19, 2004, announcing its financial results for the quarter ended March 31, 2004. (Item 12)

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MINDSPEED TECHNOLOGIES, INC.
(Registrant)

Date: May 12, 2004

By /s/ Simon Biddiscombe

Simon Biddiscombe
Senior Vice President, Chief Financial Officer,
Treasurer and Secretary
(principal financial officer)

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EXHIBIT INDEX

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31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.