

MINDSPEED TECHNOLOGIES, INC

Form 10-K

December 16, 2008

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

**Form 10-K**

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

**For the fiscal year ended October 3, 2008**

**Commission file number: 000-50499**  
**MINDSPEED TECHNOLOGIES, INC.**  
*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State of incorporation)*

**01-0616769**  
*(I.R.S. Employer  
Identification No.)*

**4000 MacArthur Boulevard, East Tower**  
**Newport Beach, California**  
*(Address of principal executive offices)*

**92660-3095**  
*(Zip code)*

**Registrant's telephone number, including area code:**  
**(949) 579-3000**

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

**(Title of Each Class)**

**(Name of Each Exchange on Which Registered)**

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

The NASDAQ Stock Market LLC

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

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

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

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

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

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

The aggregate market value of the Registrant's voting and non-voting stock held by non-affiliates of the Registrant as of the end of its most recently completed second fiscal quarter was approximately \$54 million. Shares held by each officer and director and each person owning more than 10% of the outstanding voting and non-voting stock have been excluded from this calculation because such persons may be deemed to be affiliates of the Registrant. This determination of potential affiliate status is not necessarily a conclusive determination for other purposes. Shares held include shares of which certain of such persons disclaim beneficial ownership.

The number of outstanding shares of the Registrant's Common Stock as of November 28, 2008 was 23,868,160.

#### **Documents Incorporated by Reference**

Portions of the Registrant's Proxy Statement for the 2009 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A within 120 days after the end of the 2008 fiscal year, are incorporated by reference into Part III of this Form 10-K.

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**FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains statements relating to Mindspeed Technologies, Inc. (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and are subject to the safe harbor created by those sections. All statements included in this Annual Report on Form 10-K, other than those that are purely historical, are forward-looking statements. Words such as expect, believe, anticipate, outlook, could, target, project, intend, plan, seek, estimate, and continue, as well as variations of such words and similar expressions, also identify forward-looking statements. Forward-looking statements in this Annual Report on Form 10-K include, without limitation, statements regarding:

the ability of our relationships with network infrastructure original equipment manufacturers to facilitate early adoption of our products, enhance our ability to obtain design wins and encourage adoption of our technology in the industry;

the growth prospects for the network infrastructure equipment and communications semiconductors markets, including increased demand for network capacity, the upgrade and expansion of legacy networks, and the build-out of networks in developing countries;

our plans to make substantial investments in research and development and participate in the formulation of industry standards;

our ability to achieve design wins and convert wins into revenue;

the continuation of intense price and product competition, and the resulting declining average selling prices for our products;

the value of our intellectual property and our strategy regarding sales and licensing of non-core intellectual property;

the impact of changes in customer purchasing activities, inventory levels and inventory management practices;

the importance of attracting and retaining highly skilled, dedicated personnel;

the challenges of shifting any operations or labor offshore, including the likelihood of competition in offshore markets for qualified personnel;

our ability to achieve revenue growth and sustain profitability or to sustain positive cash flows from operations;

our plans to reduce operating expenses, the amount and timing of any such expense reductions, and its effects on cash flow;

our anticipation that we will not pay a dividend in the foreseeable future;

the dependence of our operating results on our ability to develop and introduce new products and enhancements to existing products on a timely basis;

the continuation of a trend toward industry consolidation and the effect it could have on our operating results;

our belief that we are benefiting from the increased deployment of internet protocol-based networks both in new network buildouts worldwide and the replacement of circuit-switched networks;

the sufficiency of our existing sources of liquidity and expected sources of cash to fund our operations, research and development efforts, anticipated capital expenditures, working capital and other financing requirements for the next 12 months;

the circumstances under which we may need to seek additional financing, our ability to obtain any such financing and any consideration of acquisition opportunities;

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our expectation that our provision for income taxes for fiscal 2009 will principally consist of income taxes related to our foreign operations;

our expectations with respect to our recognition of income tax benefits in the future;

our restructuring plans, including expected workforce reductions, the expected cost savings under our restructuring plans and the uses of those savings, the timing and amount of payments to complete the actions, the source of funds for such payments, the impact on our liquidity and the resulting decreases in our research and development and selling, general and administrative expenses, and the amounts of future charges to complete our restructuring plans;

our beliefs regarding the effect of the disposition of pending or asserted legal matters;

our acquisition strategy, the means of financing such a strategy, and the impact of any past or future acquisitions, including the impact on revenue, margin and profitability;

our intentions to market, sell and support acquired Ethernet aggregation products and to develop and further extend the Ethernet MAC product line;

our plans relating to our use of stock-based compensation, the effectiveness of our incentive compensation programs and the expected amounts of stock-based compensation expense in future periods;

our belief that the financial stability of suppliers is an important consideration in our customers' purchasing decisions;

the amount and timing of future payments under contractual obligations;

the effects of a downturn in the semiconductor industry and the general economy at large, including the impact of slower economic activity, concerns about inflation and deflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns in the wired and wireless communications markets, recent international conflicts and terrorist and military activity and the impact of natural disasters and public health emergencies on our revenue and results of operation;

the impact of reductions, delays and cancellation of orders from key customers given our dependence on a relatively small number of end customers and distributors for a significant portion of our revenue and our lack of long term purchase commitments;

the impact of volatility in the stock market on the market price of our common stock;

the impact on our business if we fail to comply with the minimum listing requirements for continued quotation on the Nasdaq Global Market;

the effect of changes in the amount of research coverage of our common stock, changes in earnings estimates or buy/sell recommendations by analysts and changes in investor perception of us and the industry in which we operate;

the effect of shifts in our product mix and the effect of maturing products;



the continued availability and costs of products from our suppliers;

the effect of exchange rates on our ability to be competitive internationally;

our ability to continue recognizing patent related revenues from the sale of non-core patents;

market demand for our new and existing products and our ability to increase our revenues;

our intentions with respect to inventories that were previously written down;

the growth rate for products in the enterprise, network access and metro service areas and our position to increase market share;

our competitive advantages;

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competition and the principal competitive factors for semiconductor suppliers, including time to market, product quality, reliability and performance, customer support, price and total system cost, new product innovation and compliance with industry standards; and

the impact of recent accounting pronouncements and the adoption of new accounting standards.

Our expectations, beliefs, anticipations, objectives, intentions, plans and strategies regarding the future are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results, and actual events that occur, to differ materially from results contemplated by the forward-looking statement. These risks and uncertainties include, but are not limited to:

future operating losses;

cash requirements and terms and availability of financing;

worldwide political and economic uncertainties and specific conditions in the markets we address;

fluctuations in the price of our common stock and our operating results;

loss of or diminished demand from one or more key customers or distributors;

our ability to attract and retain qualified personnel;

constraints in the supply of wafers and other product components from our third-party manufacturers;

doing business internationally;

pricing pressures and other competitive factors;

successful development and introduction of new products;

our ability to successfully and cost effectively establish and manage operations in foreign jurisdictions;

industry consolidation;

order and shipment uncertainty;

our ability to obtain design wins and develop revenues from them;

lengthy sales cycles;

the expense of and our ability to defend our intellectual property against infringement claims by others;

product defects and bugs; and

business acquisitions and investments.

The forward-looking statements in this report are subject to additional risks and uncertainties, including those set forth in Item 1A Risk Factors 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, except as required by law, we undertake no obligation to update or revise any of them, whether as a result of new information, future events or otherwise. Mindspeed®, Mindspeed Technologies® and Concerto® are registered trademarks of Mindspeed Technologies, Inc. Other brands, names and trademarks contained in this report are the property of their respective owners.

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**PART I**

**Item 1. *Business***

Mindspeed Technologies, Inc. (we or Mindspeed) designs, develops and sells semiconductor networking solutions for communications applications in enterprise, broadband access, metropolitan and wide area networks. Our products, ranging from optical network transceiver solutions to voice and Internet protocol (IP) processors, are classified into three focused product families: high-performance analog products, multiservice access digital signal processor (DSP) products and wide area networking (WAN) communications products. Our products are sold to original equipment manufacturers (OEMs) for use in a variety of network infrastructure equipment, including mixed media gateways, high-speed routers, switches, access multiplexers, cross-connect systems, add-drop multiplexers, IP private branch exchanges (PBXs), optical modules and broadcast video systems. Service providers use this equipment for the processing, transmission and switching of high-speed voice, data and video traffic, including advanced services such as voice-over-IP (VoIP), within different segments of the communications network. Our customers include Alcatel-Lucent, Cisco Systems, Inc., Huawei Technologies Co. Ltd., LM Ericsson Telephone Company, Nokia Siemens Networks, Nortel Networks, Inc. and Zhongxing Telecom Equipment Corp. (ZTE).

We believe the breadth of our product portfolio, combined with more than three decades of experience in semiconductor hardware, software and communications systems engineering, provide us with a competitive advantage. We have proven expertise in signal, packet and transmission processing technologies, which are critical core competencies for successfully defining, designing and implementing advanced semiconductor products for next-generation network infrastructure equipment. We seek to cultivate close relationships with leading network infrastructure OEMs to understand emerging markets, technologies and standards. We focus our research and development efforts on applications in the segments of the telecommunications network which we believe offer the most attractive growth prospects. Our business is fabless, which means we outsource all of our manufacturing needs, and we do not own or operate any semiconductor manufacturing facilities. We believe being fabless allows us to minimize operating infrastructure and capital expenditures, maintain operational flexibility and focus our resources on the design, development and marketing of our products – the highest value-creation elements of our business model.

**Spin-off from Conexant Systems, Inc.**

Mindspeed was originally incorporated in Delaware in 2001 as a wholly owned subsidiary of Conexant Systems, Inc. On June 27, 2003, Conexant completed the distribution to Conexant stockholders of all outstanding shares of common stock of Mindspeed. In the distribution, each Conexant stockholder received one share of our common stock (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 Global Market under the ticker symbol MSPD.

Prior to the distribution, Conexant transferred to us the assets and liabilities of its Mindspeed business, including the stock of certain subsidiaries, and certain other assets and liabilities which were allocated to us under the distribution agreement entered into between us and Conexant. Also prior to the distribution, Conexant contributed to us cash in an amount such that at the time of the distribution our cash balance was \$100.0 million. We issued to Conexant a warrant to purchase six million shares (30 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of our common stock at a price of \$17.04 per share (\$3.408 on a pre-June 30, 2008 one-for-five reverse stock split basis), exercisable for a period of ten years after the distribution. In connection with the distribution, we and Conexant also entered into a Credit Agreement (terminated December 2004), an Employee Matters Agreement, a Tax Allocation Agreement, a Transition Services Agreement and a Sublease.

## **Industry Overview**

Communications semiconductor products are a critical part of network infrastructure equipment. Network infrastructure OEMs require advanced communications semiconductor products such as digital signal processors, transceivers, framers, packet and cell processors and switching solutions that are highly optimized for the

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equipment employed by their customers. We seek to provide semiconductor products that enable network infrastructure OEMs to meet the needs of their service provider and enterprise customers in terms of system performance, functionality and time-to-market.

### ***Addressed Markets***

Our semiconductor products are primarily focused on network infrastructure equipment applications in three segments of the broadly defined communications network: enterprise networks, broadband access service areas, and metropolitan and wide area networks. The type and complexity of network infrastructure equipment used in these network segments continues to expand, driven by the need for the processing, transmission and switching of digital voice, data and video traffic over multiple communication media, at numerous transmission data rates and employing different protocols.

*Enterprise* networks include equipment that is deployed primarily in the offices of commercial enterprises for voice and data communications and access to outside networks. An enterprise network may be comprised of many local area networks, as well as client workstations, centralized database management systems, storage area networks and other components. In enterprise networks, communications semiconductors facilitate the processing and transmission of voice, data and video traffic in converged IP networks that are replacing the traditional separate telephone, data and video conferencing networks. Typical network infrastructure equipment found in enterprise networks that use our products include voice gateways, IP PBXs, storage area network (SAN) routers and director class switches. In addition, a major trend in the broadcast video market is the switch from analog to digital television transmission and the conversion from standard-definition television services to high-definition television (HDTV) services featuring more detailed images and digital surround sound. We offer a family of broadcast-video products optimized for high-speed HDTV routing and production switcher applications.

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

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

The telecommunications network, including the Internet, has evolved into a complex, hybrid series of digital and optical networks that connect individuals and businesses globally. These new larger bandwidth, data-centric networks integrate voice, data and video traffic, operate over both wired and wireless media, link existing voice and data networks and cross traditional enterprise, broadband access, metro and long haul service area boundaries.

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Network infrastructure OEMs are designing faster, more intelligent and more complex equipment to satisfy the needs of the service providers as they continue to expand their network coverage and service offerings while upgrading and connecting or integrating existing networks of disparate types. In this demanding environment, we believe network infrastructure OEMs select as their strategic partners communications semiconductor suppliers who can deliver advanced products that provide increased functionality, lower total system cost and support for a variety of communications media, operating speeds and protocols.

### ***The Mindspeed Approach***

We believe the breadth of our product portfolio, combined with our expertise in semiconductor hardware, software and communications systems engineering, provide us with a competitive advantage in designing and selling our products to leading network infrastructure OEMs.

We have proven expertise in signal, packet and transmission processing technologies. Signal processing involves both signal conversion and digital signal processing techniques that convert and compress voice, data and video between analog and digital representations. Packet processing involves bundling or segmenting information traffic using standard protocols such as IP or asynchronous transfer mode (ATM) and enables sharing of transmission bandwidth across a given communication medium. Transmission processing involves the transport and receipt of voice, data and video traffic across copper wire and optical fiber communications media.

These core technology competencies are critical for developing semiconductor networking solutions that enable the processing, transmission and switching of high-speed voice, data and video traffic, employing multiple communications protocols, across disparate communications networks. Our core technology competencies are the foundation for developing our:

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

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

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

We believe the software drivers and application software are an increasingly important part of the semiconductor networking solutions we offer to OEMs.

### ***Increasing Demand for Communications Semiconductors***

We believe the market for network infrastructure equipment in general, and for communications semiconductors in particular, offers attractive long-term growth prospects for several reasons:

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

- Internet user growth;

- higher network utilization rates; and

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



We believe that incumbent telecommunications carriers, integrated communication service providers and cable multiple service operators worldwide will continue to upgrade and expand legacy portions of their networks to accommodate new service offerings and to reduce operating costs.

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

Moreover, we expect that network infrastructure OEMs will outsource more of their semiconductor component requirements to semiconductor suppliers, allowing the OEMs to reduce their operating cost structure by

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shifting their focus and investment from internal application specific integrated circuit (ASIC) semiconductor design and development to more strategic systems development.

### **Strategy**

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

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

We have established strong market positions for our products in the enterprise, broadband access and metro service areas of the telecommunications network. We believe the markets for semiconductor products that address these applications will grow at faster rates than the markets for network infrastructure equipment in general. In addition, products which address applications in the enterprise, broadband access and metro service areas and perform packet processing, transmission processing and/or signal processing functions typically command higher average selling prices and higher margins, primarily due to their functional complexity and their software content. These two key attributes are expected to make the enterprise, broadband access and metro service areas the most attractive market segments for the foreseeable future. We believe that our three core technology competencies, coupled with focused investments in product development, will position us to increase our share in those target areas.

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

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

In North America, we have cultivated close relationships with leading network infrastructure OEMs, including Cisco Systems, Inc. and Nortel Networks, Inc. Abroad, we have established close relationships with market leaders such as Huawei Technologies Co., Ltd., and Zhongxing Telecom Equipment Corp. in the Asia-Pacific region and Alcatel-Lucent, Nokia Siemens Networks, and LM Ericsson Telephone Company in Europe.

#### ***Capitalize on the Breadth of Our Product Portfolio***

We build on the breadth of our product portfolio of physical-layer devices, together with our signal and packet processing devices and communications software expertise, to increase our share of the silicon content in our customers' products. We offer a range of complementary products that are optimized to work with each other and provide our customers with complete information receipt, processing and transmission functions. These complementary products allow infrastructure OEMs to source components that provide proven interoperability from a single semiconductor supplier, rather than requiring OEMs to combine and coordinate individual components from multiple vendors. In addition, we offer highly integrated products such as our family of Comcerto packet processors that provide our customers with a complete hardware and software solution in a single device. These integrated products perform functions typically requiring multiple discrete components and software. We believe that this strategy of offering both complementary and integrated products increases product performance, speeds

time-to-market and lowers the total system cost for our customers.

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

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Through our efforts in building a large product portfolio, we have developed and we maintain a broad intellectual property portfolio. We periodically enter into strategic arrangements to leverage our portfolio by licensing or selling our patents which are no longer core to our business.

### ***Provide Outstanding Technical Support and Customer Service***

We provide broad-based technical and product design support to our customers through three dedicated teams: field application engineers, product application engineers and technical marketing personnel. We believe that comprehensive service and support are critical to shortening our customers' design cycles and maintaining a long-term competitive position within the network infrastructure equipment market. Outstanding customer service and support are important competitive factors for semiconductor component suppliers like us seeking to be the preferred suppliers to leading network infrastructure OEMs.

## **Products**

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

### ***High-Performance Analog Products***

Our high-performance analog transmission devices and switching products support storage area networking, fiber-to-the-premise and broadcast video, as well as mainstream synchronous optical networking (SONET)/synchronous digital hierarchy (SDH) and packet-over-SONET applications, typically operating at data transmission rates between 155 megabits per second (Mbps) and 10 gigabits per second (Gbps). Our transmission products include laser drivers, transimpedance amplifiers, post amplifiers, clock and data recovery circuits, serializers/deserializers, video reclockers, cable drivers and line equalizers. These products serve as the connection between a fiber optic or coaxial cable component interface and the remainder of the electrical subsystem in various network equipment and perform a variety of functions, including:

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

- conditioning the signal to remove unwanted noise or errors;

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

- amplifying and equalizing weaker signals as they pass through a particular system's equipment, media or network.

Our switching products include a family of high-speed crosspoint switches capable of switching traffic beyond 4.25 Gbps within various types of network switching equipment. These crosspoint switches direct, or transfer, a large number of high-speed data input streams, regardless of traffic type, to different connection trunks for rerouting the information to new destination points in the network. Crosspoint switches are often used to provide redundant traffic paths in networking equipment to protect against the loss of critical data from spurious network outages or failures

that may occur from time-to-time. Target equipment applications for our switching products include add-drop multiplexers, high-density IP switches, storage-area routers and optical cross-connect systems. In addition, we offer crosspoint switches optimized for standard and high-definition broadcast video routing and production switching applications at rates up to 3 Gbps.

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***Multiservice Access Processor Products***

Our software-configurable multiservice access DSP products serve as bridges for transporting voice, fax and modem transmissions between circuit-switched networks and packet-based networks. Our multiservice access DSP device architecture combines the performance of a digital-signal processor core with the flexibility of a microcontroller core to support our extensive suite of voice compression techniques, echo cancellers and communications protocols. These products process and translate voice and data and perform various management and reporting functions. They compress the signals to minimize bandwidth consumption and modify or add communications protocols to accommodate transport of the signals across a variety of different networks. Supported services include VoIP, voice-over-ATM (VoATM) and voice-over-DSL services, as well as wireline-to-wireless connectivity.

Our Comcerto family of packet processors includes a full range of software-compatible solutions that enable OEMs to provide scalable systems with customized features for carrier, enterprise and customer premise applications. The high-density members of this family, the Comcerto 600, Comcerto 700 and Comcerto 900 series processors and related software, provide a complete system-on-a-chip solution for carrier-class VoIP and VoATM applications. The Comcerto 600 is capable of handling more than 256 channels of both VoIP and VoATM traffic, while the Comcerto 700 supports more than 400 channels, and the Comcerto 900 supports more than 600 channels. All are targeted for use in media gateways designed to bridge wireless, wireline and enterprise networks.

The Comcerto 500 and 800 series solutions are designed for enterprise voice and data processing applications. The Comcerto 500 series is a silicon PBX-on-a-chip which supports all required voice processing functionality for up to 64 channels, including encryption and is also used in access gateway applications. The Comcerto 800 series enables a new class of office-in-a-box systems by combining a high-quality voice-over-packet (VoP) subsystem with a high-performance routing and virtual private network (VPN) engine. The Comcerto 800 series integrates voice processing, packet processing and encryption functionality into a single device for the rapidly growing market for VoP enterprise networks. This product is targeted for use in enterprise voice gateways, IP PBXs and integrated access devices (IADs).

The newest member of the Comcerto family, the Comcerto 100 series broadband services processor, is designed to support secure triple-play voice, video and data networks for residential and small office/home office markets. The Comcerto 100 series processor integrates high-performance security processing, packet processing and quality of service (QoS) capabilities for next-generation broadband customer premise equipment (CPE) enabling service providers to deliver sophisticated multimedia content to their subscribers.

***WAN Communications Products***

Our WAN communications products include transmission solutions and high-performance ATM/multi-protocol label switching (MPLS) network processors that facilitate the aggregation, processing and transport of voice and data traffic over copper wire or fiber optic cable to access metropolitan and long-haul networks.

Our T1/E1, T3/E3 and SONET carrier devices incorporate high-speed analog, digital and mixed-signal circuit technologies and include multi-port framers and line interface units (LIUs) or transceivers for 1.5 Mbps to 155 Mbps data transmission. Framers format data for transmission and extract data at reception, while LIUs condition signals for transmission and reception over multiple media. Our link-layer products include multi-channel, high-level data link channel (HDLC) communications controllers and multi-channel, inverse multiplexing over ATM (IMA) traffic controllers. The IMA protocol enables the aggregation of multiple T1 or DSL lines to deliver higher data rates using existing ATM infrastructure while the HDLC protocol is used for the packetization of data and the transfer of messaging and signaling information across the network. We also offer a family of symmetric DSL (SDSL) transceivers which enable service providers to deliver Internet access at data transmission rates of 1.5 Mbps to

5.7 Mbps in both directions over copper wire, supporting telecommuting and branch office functions worldwide.

Our high-performance ATM/MPLS network processors are designed to offer advanced protocol translation and traffic management capabilities. Protocol translation occurs where different types of networks and protocols interconnect. Traffic management describes a collection of functions which are used to optimally allocate network bandwidth and allow service providers to provide differentiated services over their networks. Our software-

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programmable devices operate at data transmission rates from 1.5 Mbps to 2.5 Gbps. Our network processor devices address internetworking applications, including ATM segmentation and reassembly, and a variety of traffic management functions, including traffic shaping, traffic policing and queue management, required by these applications.

Our carrier Ethernet products include Ethernet media access controllers and oversubscription aggregators which have applications in both enterprise switches and telecom edge switches. These carrier Ethernet products add traffic shaping and quality of service prioritization mechanisms in order to provide the higher degree of traffic control needed in wide area networks that base their data transmission on the Ethernet protocol prevalent in local area networks. In late fiscal 2008 we also introduced a carrier Ethernet switch component that can be used to aggregate up to ten 1 Gbps Ethernet streams to a single 10 Gbps Ethernet stream.

Our wide-area networking communications products are designed for use in a variety of equipment including digital loop carriers, DSL access multiplexers, add-drop multiplexers, switches, high-speed routers, digital cross-connect systems, optical edge devices, multiservice provisioning platforms, voice gateways and wireless base station controllers.

## **Customers**

We market and sell our semiconductor networking solutions directly to leading network infrastructure OEMs. We also sell our products indirectly through electronic component distributors and third-party electronic manufacturing service providers, which manufacture products incorporating our semiconductor networking solutions for OEMs. Sales to distributors accounted for approximately 52% of our revenues for fiscal 2008. For fiscal 2008, distributors Alltek Technology Corporation and Avnet, Inc. accounted for 16% and 11%, respectively, of our net revenues.

Our top five direct OEM customers for fiscal year 2008 were Alcatel-Lucent, Huawei Technologies Co., Oplink Communications, Inc., Samsung Electronics Co. and Zhongxing Telecom Equipment Corp. While our direct sales to these customers accounted for a total of approximately 14% of our fiscal 2008 net revenues, we believe indirect sales to these same customers represent a significant additional portion of our net revenues. We believe that our significant indirect network infrastructure OEM customers for fiscal year 2008 included Cisco Systems, Inc., Nortel Networks, Inc., and Nokia Siemens Networks, however we do not believe any of our OEM customers accounted for 10% or more of our net revenues.

Our customer base is widely dispersed geographically. Revenues derived from customers located in the Americas, Europe and the Asia-Pacific region were 36%, 13% and 51%, respectively, of our total revenues for fiscal 2008. We believe a substantial portion of the products we sell to OEMs and third-party manufacturing service providers in the Asia-Pacific region is ultimately shipped to end-markets in the Americas and Europe. See Item 8 Financial Statements and Supplementary Data, including Note 2 and Note 14 of Notes to Consolidated Financial Statements for additional information on customers and geographic areas.

## **Sales, Marketing and Technical Support**

We have a worldwide sales, marketing and technical support organization comprised of 100 employees as of October 31, 2008, located in two domestic and seven international sales locations. Our marketing, sales and field applications engineering teams, augmented by 14 electronic component distributors and 10 sales representative organizations, focus on marketing and selling semiconductor networking solutions to worldwide network infrastructure OEMs.



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

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### **Operations and Manufacturing**

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

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

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

### **Competition**

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

Our principal competitors are Applied Micro Circuits Corporation, Exar Corporation, Freescale Semiconductor, Inc., Gennum Corporation, Infineon Technologies A.G., Maxim Integrated Products, Inc., PMC-Sierra, Inc., Texas Instruments Incorporated, Transwitch Corporation and Vitesse Semiconductor Corporation.

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

- time-to-market;
- product quality, reliability and performance;
- customer support;
- price and total system cost;
- new product innovation; and
- compliance with industry standards.

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

stronger financial position and liquidity;

longer presence in key markets;

greater name recognition;

more secure supply chain;

access to larger customer bases; and

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

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As a result, these competitors may be able to devote greater resources to the development, promotion and sale of their products than we can. Our competitors may also be able to adapt more quickly to new or emerging technologies and changes in customer requirements or may be more able to respond to the cyclical fluctuations or downturns that affect the semiconductor industry from time to time. Moreover, we have incurred substantial operating losses and we anticipate future losses. If we are not successful in assuring our customers of our financial stability, our OEM customers may choose semiconductor suppliers whom they believe have a stronger financial position or liquidity, which may materially adversely affect our business.

## **Backlog**

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

## **Research and Development**

We have significant research, development, engineering and product design capabilities. As of October 31, 2008, we had 271 employees engaged in research and development activities. We perform research and product development activities at our headquarters in Newport Beach, California and at eight design centers. In order to enhance the cost-effectiveness of our operations, we have increasingly sought to shift portions of our research and development operations to jurisdictions with lower cost structures than that available in the United States. Our design centers are strategically located to take advantage of key technical and engineering talent. Our success depends to a substantial degree upon our ability to develop and introduce in a timely fashion new products and enhancements to our existing products that meet changing customer requirements and emerging industry standards. We have made and plan to make substantial investments in research and development and to participate in the formulation of industry standards. In addition, we actively collaborate with technology leaders to define and develop next-generation technologies.

We spent approximately \$56.2 million, \$57.4 million, and \$64.1 million on research and development activities in fiscal years 2008, 2007 and 2006, respectively. The decreases in our research and development expenses reflect the workforce reductions and other cost reduction actions we implemented in fiscal years 2002 through 2008.

## **Intellectual Property**

Our success and future revenue growth depend, in part, on the intellectual property that we own and develop, including patents, licenses, trade secrets, know-how, trademarks and copyrights, and on our ability to protect our intellectual property. We continuously review our patent portfolio to maximize its value to us, abandoning or selling inapplicable or less useful patents and filing new patents important to our product roadmap. Our patent portfolio may be used to avoid, defend or settle any potential litigation with respect to various technologies contained in our products. The portfolio may also provide negotiating leverage in attempts to cross-license patents or technologies with third parties. We may also seek to leverage our patent portfolio by licensing or selling our patents or other intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws, as well as employee and third-party nondisclosure and confidentiality agreements and other methods to protect our proprietary technologies and processes. In connection with our participation in the development of various industry standards, we may be required to reasonably license certain of our patents to other parties, including competitors that develop products based upon the adopted industry standards. We have also entered into agreements with certain of our customers and granted these customers the right to use our proprietary technology in the event that we file for bankruptcy protection or take other equivalent actions. While in the aggregate our intellectual property is considered important to our operations, no single patent, license, trade secret, know-how, trademark or copyright is considered of such importance that its loss or

termination would materially affect our business or financial condition.

**Employees**

As of October 31, 2008, we had 484 full-time employees, approximately 322 of whom were engineers. Our employees are not covered by any collective bargaining agreements and we have not experienced a work stoppage

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

### **Cyclicality**

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles and wide fluctuations in product supply and demand. From time to time, these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry, and in our business in particular.

In addition, our operating results are subject to substantial quarterly and annual fluctuations due to a number of factors, such as demand for network infrastructure equipment, the timing of receipt, reduction or cancellation of significant orders, fluctuations in the levels of component inventories held by our 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 availability and cost of products from our suppliers, new product and technology introductions by competitors, intellectual property disputes, and the timing and extent of product development costs.

### **Available Information**

We maintain an Internet website at <http://www.mindspeed.com>. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, and other information related to our company, are available free of charge on this site as soon as reasonably practicable after such reports are filed with or furnished to the Securities and Exchange Commission (SEC). Our Code of Business Conduct and Ethics, Guidelines on Corporate Governance and Board Committee Charters are also available on our website. We will provide reasonable quantities of paper copies of filings free of charge upon request. In addition, we will provide a copy of the Board Committee Charters to stockholders upon request. No portion of our Internet website or the information contained in or connected to the website is incorporated into this Annual Report on Form 10-K.

### **Item 1A. Risk Factors**

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 have incurred operating losses in the past and we may incur losses in future periods.***

We generated net income of \$7.2 million in fiscal 2008, however incurred net losses of \$21.9 million in fiscal 2007 and \$24.5 million in fiscal 2006. We may incur losses and negative cash flows in future periods.

In order to sustain profitability and positive cash flows from operations, we must further reduce operating expenses and/or increase our revenues. We have completed a series of cost reduction actions which have improved our operating cost structure, and we will continue to perform additional actions, when necessary. These expense reductions alone may not allow us to sustain the profitability we achieved in the fourth quarter of fiscal 2008. Our ability to achieve the necessary revenue growth will depend on increased demand for network infrastructure equipment that incorporates our products, which in turn depends primarily on the level of capital spending by communications service providers and enterprises, the level of which may decrease due to general economic

conditions, and uncertainty, over which we have no control. We may not be successful in achieving the necessary revenue growth or the expected expense reductions. Moreover, we may be unable to sustain past or expected future expense reductions in subsequent periods. We may not be able to sustain the profitability achieved in fiscal 2008.

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***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 fiscal 2008, we generated \$26.7 million in cash from operating activities compared to net cash used in operating activities of \$10.0 million in fiscal 2007 and \$15.9 million in fiscal 2006. Our principal sources of liquidity are our existing cash balances and cash generated from product sales and sales of intellectual property. As of October 3, 2008, our cash and cash equivalents totaled \$43.0 million. 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 12 months, including the repayment of the remaining \$10.5 million in senior convertible debt due in November 2009. However, this may not be the case, and if we 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. We have recently completed transactions that involved the issuance or incurrence of indebtedness, including credit facilities. Even after completing these transactions, we may need additional capital in the future and may not have access to additional sources of capital on favorable terms or at all. If we raise additional funds through the issuance of equity, equity-based or debt securities, such securities may have rights, preferences or privileges senior to those of our common stock and our stockholders may experience dilution of their ownership interests. In addition, there can be no assurance that we will continue to benefit from the sale of non-core patents as we have in previous periods.

***Our operating results may be adversely impacted by worldwide political and economic uncertainties and specific conditions in the markets we address, including the cyclical nature of and volatility in the semiconductor industry. As a result, the market price of our common stock may decline.***

We operate primarily in the semiconductor industry, which is cyclical and subject to rapid change and evolving industry standards. From time to time, the semiconductor industry has experienced significant downturns. These downturns are characterized by decreases in product demand, excess customer inventories and accelerated erosion of prices. These factors could cause substantial fluctuations in our revenue and in our results of operations. Any downturns in the semiconductor industry may be severe and prolonged, and any failure of the industry or wired and wireless communications markets to fully recover from downturns could seriously impact our revenue and harm our business, financial condition and results of operations. The semiconductor industry also periodically experiences increased demand and production capacity constraints, which may affect our ability to ship products. Accordingly, our operating results may vary significantly as a result of the general conditions in the semiconductor industry, which could cause large fluctuations in our stock price.

Additionally, recently general worldwide economic conditions have experienced a significant downturn due to slower economic activity, concerns about inflation and deflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns in the wired and wireless communications markets, recent international conflicts and terrorist and military activity, and the impact of natural disasters and public health emergencies. These conditions make it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and they could cause U.S. and foreign businesses to slow spending on our products and services, which would delay and lengthen sales cycles. We cannot predict the timing, strength or duration of any worldwide economic slowdown or subsequent economic recovery, or in the semiconductor industry or the wired and wireless communications markets. If the economy or markets in which we operate do not return to historical levels, our business, financial condition and results of operations will likely be materially and adversely affected. Additionally, the combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could have a synergistic negative impact on the results of our operations.





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***The price of our common stock may fluctuate significantly.***

The price of our common stock is volatile and may fluctuate significantly. There can be no assurance as to the prices at which our common stock will trade or that an active trading market in our common stock will be sustained in the future. The market price at which our common stock trades may be influenced by many factors, including:

our operating and financial performance and prospects, including our ability to sustain the profitability we achieved in the fourth quarter of fiscal 2008;

the depth and liquidity of the market for our common stock which can impact, among other things, the volatility of our stock price and the availability of market participants to borrow shares;

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. If our common stock trades below \$1.00 for 30 consecutive trading days, or if we otherwise do not meet the requirements for continued quotation on the Nasdaq Global Market (NASDAQ), our common stock could be delisted which would adversely affect the ability of investors to sell shares of our common stock and could otherwise adversely affect our business. During fiscal 2008, our common stock traded below \$1.00 for 30 consecutive trading days. In order to regain compliance with the minimum bid price rule, we effected a one-for-five reverse stock split on June 30, 2008.

On October 16, 2008, NASDAQ filed a rule change with the SEC to suspend temporarily the continued listing requirements relating to bid price and market value of publicly held shares through January 16, 2009. In November 2009, our stock price began trading below \$1.00 per share. We can provide no assurance that we will be in compliance with the minimum bid price rule once the suspension is lifted.

***Our operating results are subject to substantial quarterly and annual fluctuations.***

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

the gain or loss of significant customers;

market acceptance of our products and our customers' products;

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

intellectual property disputes;

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

fluctuations in the levels of component inventories held by our customers and changes in our customers' inventory management practices;

shifts in our product mix and the effect of maturing products;

availability and cost of products from our suppliers;

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the timing and extent of product development costs;

new product and technology introductions by us or our competitors;

fluctuations in manufacturing yields; and

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

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly or annual operating results.

***The loss of one or more key customers or distributors, or the diminished demand for our products from a key customer could significantly reduce our revenues and profits.***

A relatively small number of end customers and distributors have accounted for a significant portion of our revenues in any particular period. We have no long-term volume purchase commitments from our key customers. One or more of our key customers or distributors may discontinue operations as a result of consolidation, liquidation or otherwise. Reductions, delays and cancellation of orders from our key customers or the loss of one or more key customers could significantly reduce our revenues and profits. We cannot assure you that our current customers will continue to place orders with us, that orders by existing customers will continue at current or historical levels or that we will be able to obtain orders from new customers.

***Our operating results are subject to substantial quarterly and annual fluctuations.***

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

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availability and cost of products from our suppliers;

the timing and extent of product development costs;

new product and technology introductions by us or our competitors;

fluctuations in manufacturing yields; and

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

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly or annual operating results.

***We may not be able to attract and retain qualified personnel necessary for the design, development, sale and support 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, technical and support personnel. As the source of our technological

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and product innovations, our key technical personnel represent a significant asset. The competition for such personnel can be intense in the semiconductor industry. We may not be able to attract and retain qualified management and other personnel necessary for the design, development, sale and support of our products.

In periods of poor operating performance, we have experienced, and may experience in the future, particular difficulty attracting and retaining key personnel. If we are not successful in assuring our employees of our financial stability and our prospects for success, our employees may seek other employment, which may materially and adversely affect our business. Moreover, our recent expense reduction and restructuring initiatives, including a series of worldwide workforce reductions, have reduced the number of our technical employees. We intend to continue to expand our international business activities including expansion of design and operational centers abroad and may have difficulty attracting and maintaining international 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.

Many 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 are entirely dependent upon third parties for the manufacture 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. Our principal suppliers of wafer fabrication services are TSMC and Jazz. We are also dependent upon third parties, including Amkor, for the assembly and testing of all of our products. 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 capacity for wafer fabrication and assembly and test services.

The risks associated with our reliance on third parties for manufacturing services include:

- the lack of assured supply, potential shortages and higher prices;
- increased lead times;
- 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.

Our standard lead time, or the time required to manufacture our products (including wafer fabrication, assembly and testing) is typically 12 to 16 weeks. During periods of manufacturing capacity shortages, the foundries and other suppliers on whom we rely may devote their limited capacity to fulfill the production requirements of other clients that are larger or better financed than we are, or who have superior contractual rights to enforce the manufacture of their products, including to the exclusion of producing our products.

Additionally, if we are required to seek alternative foundries or assembly and test service providers, we would be subject to longer lead times, indeterminate delivery schedules and increased manufacturing costs, including costs to find and qualify acceptable suppliers. For example, if we choose to use a new foundry, the qualification process may take as long as six months over the standard lead time before we can begin shipping products from the new foundry. Such delays could negatively affect our relationships with our customers.

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

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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 deteriorations in general economic conditions, 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 and in California. In the event of a disruption of the operations of one or more of our suppliers, we may not have an alternate source immediately available. Such an event could cause significant delays in shipments until we are able to 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 manufacturing 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 the risks of doing business internationally.***

A significant part of our strategy involves our continued pursuit of growth opportunities in a number of international markets. We market, sell, design and service our products internationally. Sales to customers located outside the United States, primarily in the Asia-Pacific region and Europe, were approximately 68% of our net revenues for fiscal 2008. In addition, we have design centers, customer support centers, and rely on 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 which could adversely affect our ability to increase or maintain our foreign sales. These include, but are not limited to, risks regarding:

currency exchange rate fluctuations;

local economic and political conditions;

disruptions of capital and trading markets;

accounts receivable collection and longer payment cycles;

difficulties in staffing and managing foreign operations;

potential hostilities and changes in diplomatic and trade relationships;

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;

environmental laws and regulations governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety;

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tax laws;

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

cultural differences in the conduct of business; and

natural disasters, acts of terrorism and war.

Because most of our international sales 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. As we continue to shift a portion of our operations offshore, more of our expenses are incurred in currencies other than those in which we bill for the related services. An increase in the value of certain currencies, such as the Euro, Ukrainian hryvnia and Indian rupee, against the U.S. dollar could increase costs of our offshore operations by increasing labor and other costs that are denominated in local currencies.

From time to time we may enter into foreign currency forward exchange contracts to mitigate the 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 adversely affected by currency fluctuations.

***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 U.S. and international semiconductor manufacturers that are both larger and smaller than we are 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;

more secure supply chain;

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 incurred substantial operating losses and we may continue to incur losses in future periods. We believe that financial stability of suppliers is an important consideration in our customers purchasing decisions. If our OEM customers perceive that we lack adequate financial stability, they may choose semiconductor suppliers that 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 may not 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 and keep abreast of the rapid technological changes in our market.***

Our operating results will depend largely on our ability to continue to introduce new and enhanced semiconductor products on a timely basis as well as our ability to keep abreast of rapid technological changes

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in our markets. Our products could become obsolete sooner than we expect because of faster than anticipated, or unanticipated, changes in one or more of the technologies related to our products. The introduction of new technology representing a substantial advance over current technology could adversely affect demand for our existing products. Currently accepted industry standards are also subject to change, which may also contribute to the obsolescence of our products. If we are unable to develop and introduce new or enhanced products in a timely manner, our business may be adversely affected.

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 may not 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 evaluate expenditures for planned product development continually and to choose among alternative technologies based on our expectations of future market growth. We may be unable to develop and introduce new or enhanced products in a timely manner, our products may not satisfy customer requirements or achieve market acceptance, or we may be unable to anticipate new industry standards and technological changes. We also may not be able to respond successfully to new product announcements and introductions by competitors.

Research and development projects may experience unanticipated delays related to our internal design efforts. New product development also requires the production of photomask sets and the production and testing of sample devices. In the event we experience delays in obtaining these services from the wafer fabrication and assembly and test vendors on whom we rely, our product introductions may be delayed and our revenues and results of operations may be adversely affected.

***The increasing significance of our foreign operations exposes us to risks that are beyond our control and could affect our ability to operate successfully.***

In order to enhance the cost-effectiveness of our operations, we have increasingly sought to shift portions of our research and development and customer support operations to jurisdictions with lower cost structures than that available in the United States. The transition of even a portion of our business operations to new facilities in a foreign country involves a number of logistical and technical challenges that could result in product development delays and operational interruptions, which could reduce our revenues and adversely affect our business. We may encounter complications associated with the set-up, migration and operation of business systems and equipment in a new facility. This could result in delays in our research and development efforts and otherwise disrupt our operations. If such delays or disruptions occur, they could damage our reputation and otherwise adversely affect our business and results of operations.

To the extent that we shift any operations or labor offshore to jurisdictions with lower cost structures, we may experience challenges in effectively managing those operations as a result of several factors, including time zone

differences and regulatory, legal, cultural and logistical issues. Additionally, the relocation of labor resources may have a negative impact on our existing employees, which could negatively impact our operations. If we are unable to effectively manage our offshore research and development staff and any other offshore operations, our business and results of operations could be adversely affected.

We cannot be certain that any shifts in our operations to offshore jurisdictions will ultimately produce the expected cost savings. We cannot predict the extent of government support, availability of qualified workers, future labor rates or monetary and economic conditions in any offshore locations where we may operate. Although some of

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these factors may influence our decision to establish or increase our offshore operations, there are inherent risks beyond our control, including:

political uncertainties;

wage inflation;

exposure to foreign currency fluctuations;

tariffs and other trade barriers; and

foreign regulatory restrictions and unexpected changes in regulatory environments.

We will likely be faced with competition in these offshore markets for qualified personnel, including skilled design and technical personnel, and we expect this competition to increase as companies expand their operations offshore. If the supply of such qualified personnel becomes limited due to increased competition or otherwise, it could increase our costs and employee turnover rates. One or more of these factors or other factors relating to foreign operations could result in increased operating expenses and make it more difficult for us to manage our costs and operations, which could cause our operating results to decline and result in reduced revenues.

***Industry consolidation may harm our operating results.***

There has been an increasing trend toward industry consolidation in our markets in recent years, particularly among major network equipment and telecommunications companies. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. While we cannot predict how consolidation in our industry will affect our customers or competitors, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants. Increased consolidation and competition for fewer customers may result in pricing pressures or a loss in market share, each of which could materially impact our business.

***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 52% of our revenues for fiscal 2008.

Because of the significant lead times for wafer fabrication and assembly and test services, we routinely purchase inventory based on estimates of end-market demand for our customers' products. End-market demand may be subject to dramatic changes and is difficult to predict. End-market demand is highly influenced by the timing and extent of carrier capital expenditures which may decrease due to general economic conditions, and uncertainty, over which we have no control. The difficulty in predicting demand 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. Conversely, if we fail to anticipate inventory needs we may be unable to fulfill demand for our products, resulting in a loss of potential revenue.

***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 is more difficult for us to achieve future design wins with that OEM's product platform because

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changing suppliers involves significant cost, time, effort and risk for the OEM. 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 generally 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. These lengthy periods also increase 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 any revenues from new products. We may never generate the anticipated revenues if our customers cancel or change their product plans as customers may increasingly do if economic conditions continue to deteriorate.

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

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 against technologies that are important to our business. The resolution or compromise of any litigation or other legal process to enforce such alleged third party 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 may not prevail in any such litigation or other legal process or we may compromise or settle such claims because of the complex technical issues and inherent uncertainties in intellectual property disputes and the significant expense in defending such claims. If litigation or other legal process results in adverse rulings, we may 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 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.



In connection with the distribution, we generally assumed responsibility for all contingent liabilities and litigation against Conexant or its subsidiaries related to our business.

*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. We may be required to engage in litigation to enforce or protect our intellectual property rights, which

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may require us to expend significant resources and to divert the efforts and attention of our management from our business operations; in particular:

the steps we take to prevent misappropriation or infringement of our intellectual property may not be successful;

any existing or future patents may be challenged, invalidated or circumvented; or

the measures described above may not provide meaningful protection.

Despite the preventive measures and precautions that we take, a third party could copy or otherwise obtain and use our technology without authorization, develop similar technology independently or design around our patents. We generally enter into confidentiality agreements with our employees, consultants and strategic partners. We also try to control access to and distribution of our technologies, documentation and other proprietary information. Despite these efforts, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization. Also, former employees may seek employment with our business partners, customers or competitors, and the confidential nature of our proprietary information may not be maintained in the course of such future employment. Further, in some countries outside the United States, patent protection is not available or not reliably enforced. Some countries that do allow registration of patents do not provide meaningful redress for patent violations. As a result, protecting intellectual property in those countries is difficult and competitors may sell products in those countries that have functions and features that infringe on our intellectual property.

***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, our products are complex and 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, errors, defects and bugs. If any of our products contain production defects or reliability, safety, 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. We could also be exposed to product liability claims or indemnification claims by our customers. These costs or damages could have a material adverse effect on our financial condition and results of operations.

***We may make business acquisitions or investments, which involve significant risk.***

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

issuances of equity securities dilutive to our existing stockholders;

substantial cash payments;

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, customers and suppliers of the acquired business.

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Integrating acquired organizations and their products and services may be expensive, time-consuming and a strain on our resources and our relationships with employees, customers and suppliers, and ultimately may not be successful. The benefits or synergies we may expect from the acquisition of complementary or supplementary businesses may not be realized to the extent or in the time frame we initially anticipate.

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

***Our results of operations could vary as a result of the methods, estimates and judgments we use in applying our accounting policies.***

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on our results of operations (see Critical Accounting Policies and Estimates in Part I, Item 7 of this Form 10-K). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and changes in rule making by various regulatory bodies. Factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations.

***Substantial sales of the shares of our common stock issuable upon conversion of our convertible senior notes or exercise of the warrant issued to Conexant could adversely affect our stock price or our ability to raise additional financing in the public capital markets.***

Conexant holds a warrant to acquire six million shares (adjusted to reflect our June 30, 2008 one-for-five reverse stock split) of our common stock at a price of \$17.04 per share (adjusted to reflect our June 30, 2008 one-for-five reverse stock split), exercisable through June 27, 2013, representing approximately 15% of our outstanding common stock on a fully diluted basis. The warrant may be transferred or sold in whole or part at any time. If Conexant sells the warrant or if Conexant or a transferee of the warrant exercises the warrant 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. Currently, we have \$25.5 million aggregate principal amount of convertible senior notes outstanding. These notes are convertible at any time, at the option of the holder, into a total of approximately 4.1 million shares (adjusted to reflect our June 30, 2008 one-for-five reverse stock split) of common stock. The conversion of the notes and subsequent sale of a substantial number of shares of our common stock could also adversely affect demand for, and the market price of, our common stock. Each of these transactions could adversely affect our ability to raise additional financing by issuing equity or equity-based securities in the public capital markets.

***Antidilution and other provisions in the warrant issued to Conexant may also adversely affect our stock price or our ability to raise additional financing.***

The warrant issued to Conexant contains antidilution provisions that provide for adjustment of the warrant's exercise price, and the number of shares issuable under the warrant, upon the occurrence of certain events. If we issue, or are deemed to have issued, shares of our common stock, or securities convertible into our common stock, at prices below the current market price of our common stock (as defined in the warrant) at the time of the issuance of such securities, the warrant's exercise price will be reduced and the number of shares issuable under the warrant will be increased. The amount of such adjustment if any, will be determined pursuant to a formula specified in the warrant and will depend on the number of shares issued, the offering price and the current market price of our common stock at the time of the issuance of such securities. Adjustments to the warrant pursuant to these antidilution provisions may result in

significant dilution to the interests of our existing stockholders and may adversely affect the market price of our common stock. The antidilution provisions may also limit our ability to obtain additional financing on terms favorable to us.

Moreover, we may not realize any cash proceeds from the exercise of the warrant held by Conexant. A holder of the warrant may opt for a cashless exercise of all or part of the warrant. In a cashless exercise, the holder of the warrant would make no cash payment to us, and would receive a number of shares of our common stock having an

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aggregate value equal to the excess of the then-current market price of the shares of our common stock issuable upon exercise of the warrant over the exercise price of the warrant. Such an issuance of common stock would be immediately dilutive to the interests of other stockholders.

*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. Several of our directors and executive officers own Conexant common stock and hold options to purchase Conexant common stock. Service on our board of directors 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 warrant to purchase our common stock issued to Conexant, or with respect to other agreements made 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 and restated bylaws, our amended 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 and restated 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 stockholders;

a prohibition on stockholder action by written consent;

a requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders;

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 and restated bylaws;

elimination of the right of stockholders to call a special meeting of stockholders; and

a fair price provision.

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

**Table of Contents****Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

At October 31, 2008, we occupied our headquarters located in Newport Beach, California (which includes design and sales offices), eight design centers and nine sales locations. These facilities had an aggregate floor space of approximately 219,000 square feet, all of which is leased, consisting of approximately 144,000 square feet at our headquarters, 58,000 square feet at our design centers and 17,000 square feet at our sales locations. We believe our properties are well maintained, are in sound operating condition and contain all the equipment and facilities to operate at present levels.

Through our design centers, we provide design engineering and product application support and after-sales service to our OEM customers. The design centers are strategically located to take advantage of key technical and engineering talent worldwide.

**Item 3. *Legal Proceedings***

We are currently not engaged in legal proceedings that require disclosure under this Item.

**Item 4. *Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of our stockholders during the quarter ended October 3, 2008.

**PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****Market Information**

Our common stock is traded on the Nasdaq Global Market under the symbol MSPD. The following table lists the high and low closing sales price of our common stock as reported by the Nasdaq Global Market for the periods indicated, adjusted to reflect our June 30, 2008 one-for-five reverse stock split.

	<b>High</b>	<b>Low</b>
<b><i>Fiscal 2007</i></b>		
Quarter ended December 29, 2006	\$ 10.25	\$ 8.10
Quarter ended March 30, 2007	\$ 12.65	\$ 8.75
Quarter ended June 29, 2007	\$ 11.90	\$ 9.75
Quarter ended September 28, 2007	\$ 11.25	\$ 7.95
<b><i>Fiscal 2008</i></b>		
Quarter ended December 28, 2007	\$ 9.20	\$ 5.65
Quarter ended March 28, 2008	\$ 6.10	\$ 2.40
Quarter ended June 27, 2008	\$ 4.75	\$ 2.35



Quarter ended October 3, 2008

\$ 4.40 \$ 2.08

**Recent Share Prices and Holders**

The last reported sale price of our common stock on December 12, 2008 was \$1.05 and there were approximately 30,210 holders of record of our common stock. However, many holders' shares are listed under their brokerage firms' names.

**Table of Contents****Dividend Policy**

We have never paid cash dividends on our capital stock. We currently intend to retain any earnings for use in our business and do not anticipate paying cash dividends in the foreseeable future. Our current revolving credit facility restricts our ability to pay cash dividends on our common stock without the lender's consent. Our future dividend policy will depend on our earnings, capital requirements and financial condition, as well as requirements of our financing agreements and other factors that our board of directors considers relevant.

**Item 6. Selected Financial Data**

The selected consolidated financial data presented below should be read in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto appearing elsewhere in this Annual Report on Form 10-K. Our consolidated selected financial data have been derived from our audited consolidated financial statements.

	<b>Oct. 3, 2008</b>	<b>Sept. 28, 2007</b>	<b>Sept. 29, 2006</b>	<b>Sept. 30, 2005</b>	<b>Oct. 1, 2004</b>
	<b>(In thousands, except per share amounts)</b>				
<b>Statement of Operations Data</b>					
Net revenues:					
Products	\$ 144,349	\$ 125,805	\$ 135,919	\$ 111,777	\$ 119,435
Intellectual Property	16,350	2,000			
Total net revenues	160,699	127,805	135,919	111,777	119,435
Cost of goods sold	47,625	42,334	43,592	33,704	35,149
Gross margin	113,074	85,471	92,327	78,073	84,286
Operating expenses:					
Research and development	56,217	57,447	64,104	71,355	79,582
Selling, general and administrative	46,984	43,385	46,970	41,871	46,845
Amortization of intangible assets				20,481	50,318
Special charges(1)	211	4,724	2,550	5,999	387
Total operating expenses	103,412	105,556	113,624	139,706	177,132
Operating income/(loss)	9,662	(20,085)	(21,297)	(61,633)	(92,846)
Interest expense	(2,360)	(2,240)	(2,231)	(1,788)	
Other income, net	544	522	863	1,162	320
Income/(loss) before income taxes	7,846	(21,803)	(22,665)	(62,259)	(92,526)
Provision for income taxes	611	111	1,849	370	721
Net income/(loss)	\$ 7,235	\$ (21,914)	\$ (24,514)	\$ (62,629)	\$ (93,247)
Income/(loss) per share:					
Income/(loss) per share, basic(2)	\$ 0.31	\$ (0.99)	\$ (1.16)	\$ (3.06)	\$ (4.75)
Income/(loss) per share, diluted(2)	\$ 0.31	\$ (0.99)	\$ (1.16)	\$ (3.06)	\$ (4.75)

Shares used in computation of net  
income/(loss) per share, in thousands:

Basic(2)	23,046	22,156	21,107	20,438	19,628
Diluted(2)	23,202	22,156	21,107	20,438	19,628

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	<b>Oct. 3, 2008</b>	<b>Sept. 28, 2007</b>	<b>Sept. 29, 2006</b>	<b>Sept. 30, 2005</b>	<b>Oct. 1, 2004</b>
<b>Balance Sheet Data</b>					
Cash and cash equivalents	\$ 43,033	\$ 25,796	\$ 29,976	\$ 15,335	\$ 43,638
Marketable securities			11,260	40,094	
Working capital	50,277	35,814	50,880	59,332	49,082
Total assets	100,604	82,079	96,542	105,504	126,300
Long-term debt	45,648	45,037	44,618	44,219	
Stockholders' equity	27,958	14,246	23,476	33,826	90,927

(1) Special charges consist of asset impairments, restructuring charges, separation costs and gains and losses on the sale of certain assets.

(2) Adjusted to reflect our one-for-five reverse stock split which was effected on June 30, 2008.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

We design, develop and sell semiconductor networking solutions for communications applications in enterprise, broadband access, metropolitan and wide-area networks. Our products, ranging from optical network transceiver solutions to voice and Internet protocol (IP) processors, are classified into three focused product families: high-performance analog products, multiservice access digital signal processor (DSP) products and wide area networking (WAN) communications products. Our products are sold to original equipment manufacturers (OEMs) for use in a variety of network infrastructure equipment, including mixed media gateways, high-speed routers, switches, access multiplexers, cross-connect systems, add-drop multiplexers, IP private branch exchanges (PBXs), optical modules and broadcast video systems. Service providers use this equipment for the processing, transmission and switching of high-speed voice, data and video traffic, including advanced services such as voice-over-IP (VoIP), within different segments of the communications network. Our customers include Alcatel-Lucent, Cisco Systems, Inc., Huawei Technologies Co., LM Ericsson Telephone Company, Nokia Siemens Networks, Nortel Networks, Inc. and Zhongxing Telecom Equipment Corp. (ZTE).

**Trends and Factors Affecting Our Business**

Our products are components of network infrastructure equipment. As a result, we rely on network infrastructure OEMs to select our products from among alternative offerings to be designed into their equipment. These design wins are an integral part of the long sales cycle for our 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. We believe our close relationships with leading network infrastructure OEMs facilitate early adoption of our products during development of their products, enhance our ability to obtain design wins and encourage adoption of our technology by the industry.

We market and sell our semiconductor products directly to 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 52% of our revenues for fiscal 2008. Sales to customers located outside the United

States, primarily in the Asia-Pacific region and Europe, were approximately 68% of our net revenues for fiscal 2008. We believe a substantial portion of the products we sell to OEMs and third-party manufacturing service providers in the Asia-Pacific region is ultimately shipped to end markets in the Americas and Europe.

We have significant research, development, engineering and product design capabilities. Our success depends to a substantial degree upon our ability to develop and introduce in a timely fashion new products and enhancements to our existing products that meet changing customer requirements and emerging industry standards. We have made, and plan to make, substantial investments in research and development and to participate in the formulation of industry standards. We spent approximately \$56.2 million on research and development in fiscal 2008. We seek

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to maximize our return on our research and development spending by focusing our research and development investment in what we believe are key high-growth markets, including VoIP and high-performance analog applications. We have developed and maintain a broad intellectual property portfolio, and we intend to periodically enter into strategic arrangements to leverage our portfolio by licensing or selling our patents which are no longer core to our business. We recognized our first revenues from the sale of patents during the fourth quarter of fiscal 2007 and continued to recognize patent related revenues throughout fiscal 2008. We anticipate continuing this intellectual property strategy in future periods.

We are dependent upon third parties for the manufacture, assembly and testing of our products. Our ability to bring new products to market, to fulfill orders and to achieve long-term revenue growth is dependent on our ability to obtain sufficient external manufacturing capacity, including wafer fabrication capacity. Periods of upturn in the semiconductor industry may be characterized by rapid increases in demand and a shortage of capacity for wafer fabrication and assembly and test services. In such periods, we may experience longer lead times or indeterminate delivery schedules, which may adversely affect our ability to fulfill orders for our products. During periods of capacity shortages for manufacturing, assembly and testing services, our primary foundries and other suppliers may devote their limited capacity to fulfill the requirements of other clients that are larger than we are, or who have superior contractual rights to enforce manufacture of their products, including to the exclusion of producing our products. We may also incur increased manufacturing costs, including costs of finding acceptable alternative foundries or assembly and test service providers. In order to sustain profitability and positive cash flows from operations, we may need to further reduce operating expenses and/or increase our revenues. Through fiscal 2008, we have completed a series of cost reduction actions which have improved our operating cost structure. In the first quarter of fiscal 2009, we announced a restructuring plan. We anticipate incurring special charges of between \$2.7 and \$3.2 million dollars during the first and second quarters of fiscal 2009, primarily associated with severance costs for affected employees. When we complete these restructuring actions, we estimate we will achieve annualized savings of between \$4.5 and \$5.1 million dollars.

Our ability to achieve revenue growth will depend on increased demand for network infrastructure equipment that incorporates our products, which in turn depends primarily on the level of capital spending by communications service providers the level of which may decrease due to general economic conditions, and uncertainty, over which we have no control. We believe the market for network infrastructure equipment in general, and for communications semiconductors in particular, offers attractive long-term growth prospects due to increasing demand for network capacity, the continued upgrading and expansion of existing networks and the build-out of telecommunication networks in developing countries. However, 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. In addition, there has been an increasing trend toward industry consolidation, particularly among major network equipment and telecommunications companies. Consolidation in the industry may lead to pricing pressure and loss of market share. These factors have caused substantial fluctuations in our revenues and our results of operations in the past, and we may experience cyclical fluctuations in our business in the future.

On February 29, 2008, we received a letter from The NASDAQ Stock Market notifying us that for the 30 consecutive business days preceding the date of the letter the bid price of our common stock had closed below the \$1.00 per share minimum bid price required for continued inclusion on The NASDAQ Global Market pursuant to NASDAQ Marketplace Rule 4450(a)(5). In order to regain compliance with the minimum bid price rule, we effected a one-for-five reverse stock split on June 30, 2008.

On July 23, 2008, we received a letter from NASDAQ informing us that the closing bid price of our common stock met or exceeded \$1.00 per share for a minimum of ten consecutive business days. Accordingly, we have regained compliance with Marketplace Rule 4450(a)(5).

On October 16, 2008, NASDAQ filed a rule change with the SEC to suspend temporarily the continued listing requirements relating to bid price and market value of publicly held shares through January 16, 2009. In November 2009, our stock price began trading below \$1.00 per share. We can provide no assurance that we will be in compliance with the minimum bid price rule once the suspension is lifted.

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### **Stock-Based Compensation Programs**

We use stock-based compensation to attract and retain employees and to provide long-term incentive compensation that further aligns the interests of our employees with those of our stockholders. Prior to fiscal 2006, our stock-based compensation consisted principally of stock options. Eligible employees received grants of stock options at the time of hire; we also made broad-based stock option grants covering substantially all of our employees annually. Stock option awards have exercise prices not less than the market price of our common stock at the grant date and a contractual term of eight or ten years, and are subject to time-based vesting (generally over four years). From time to time we have also used restricted stock awards with time-based vesting for incentive or retention purposes.

Beginning in fiscal 2006, we revised our stock-based compensation arrangements to provide current and long-term incentive compensation, principally through restricted stock awards. During the last three fiscal years, we granted an aggregate of 0.8 million (fiscal 2008), 0.6 million (fiscal 2007) and 0.8 million (fiscal 2006) shares of restricted stock (adjusted to reflect our June 30, 2008 one-for-five reverse stock split) to our employees. These awards principally consisted of broad-based grants, covering substantially all of our employees. One broad-based grant was intended to provide performance emphasis and incentive compensation through vesting tied to each employee's performance against individual goals for each of the fiscal years. Another broad-based grant of restricted stock was intended to provide long-term incentive compensation; these awards vest ratably over a period of four years, and require continued service. In fiscal 2006, certain senior management personnel also received additional restricted stock awards having vesting tied to our achievement of an operating profit.

From time to time, we also grant stock options or other stock-based awards for incentive, retention or inducement purposes. We periodically review, and may further revise, our compensation arrangements based on our assessment of the effectiveness of our compensation arrangements and to keep our overall compensation package at market levels.

Effective October 1, 2005, we adopted Financial Accounting Standards (SFAS) 123R, *Share-Based Payment* using the modified prospective application. SFAS 123R requires that we account for all stock-based compensation transactions using a fair-value method and recognize the fair value of each award as an expense over the service period. As required by SFAS 123R, our stock-based compensation expense for fiscal 2008, fiscal 2007 and fiscal 2006 includes the fair value of new awards, modified awards and any unvested awards outstanding at October 1, 2005. The fair value of restricted stock awards is based upon the market price of our common stock at the grant date. We estimate the fair value of stock option awards, as of the grant date, using the Black-Scholes option-pricing model. The fair value of each award is recognized on a straight-line basis over the vesting or service period.

Stock-based compensation expense totaling \$5.5 million, \$7.3 million, and \$7.5 million for fiscal 2008, fiscal 2007, and fiscal 2006, respectively, is included in cost of goods sold, research and development expenses, selling, general and administrative expenses and special charges. As of October 3, 2008, there was unrecognized compensation expense of \$2.0 million related to unvested stock options, which we expect to recognize over a weighted-average period of 1.4 years and unrecognized compensation expense of \$2.0 million related to unvested restricted stock awards, which we expect to recognize over a weighted-average period of 0.9 years.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with generally accepted accounting principles 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. Among the significant estimates affecting our consolidated financial statements are those relating to inventories, revenue recognition, allowances for doubtful accounts, stock-based compensation, income taxes and impairment of long-lived assets. We regularly evaluate our estimates and



assumptions based upon historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent actual results differ from those estimates, our future results of operations may be affected.

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*Inventories* We write down our inventory for estimated obsolete or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than our estimates, additional inventory write-downs may be required. In the event we experience unanticipated demand and are able to sell a portion of the inventories we have previously written down, our gross margins will be favorably affected.

*Stock-Based Compensation* We account for stock-based compensation in accordance with SFAS No. 123R, Share-Based Payment. SFAS 123R requires that we account for all stock-based compensation transactions using a fair-value method and recognize the fair value of each award as an expense over the service period. The fair value of restricted stock awards is based upon the market price of our common stock at the grant date. We estimate the fair value of stock option awards, as of the grant date, using the Black-Scholes option-pricing model. The use of the Black-Scholes model requires that we make a number of estimates, including the expected option term, the expected volatility in the price of our common stock, the risk-free rate of interest and the dividend yield on our common stock. If our expected option term and stock-price volatility assumptions were different, the resulting determination of the fair value of stock option awards could be materially different. In addition, judgment is also required in estimating the number of share-based awards that we expect will ultimately vest upon the fulfillment of service conditions (such as time-based vesting) or the achievement of specific performance conditions. If the actual number of awards that ultimately vest differs significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

*Revenue Recognition* Our products are often integrated with software that is essential to the functionality of the equipment. Additionally, we provide unspecified software upgrades and enhancements through our maintenance contracts for many of our products. Accordingly, we account for revenue in accordance with Statement of Position No. 97-2, Software Revenue Recognition, and all related interpretations. For sales of products where software is incidental to the equipment, we apply the provisions of Staff Accounting Bulletin No. 104, Revenue Recognition, and all related interpretations.

We generate revenues from direct product sales, sales to distributors, maintenance contracts, development agreements and the sale and license of intellectual property. We recognize revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) our price to the customer is fixed or determinable; and (iv) collection of the sales price is reasonably assured. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Technical support services revenue is deferred and recognized ratably over the period during which the services are to be performed. Advanced services revenue is recognized upon delivery or completion of performance.

We recognize revenues on products shipped directly to customers at the time the products are shipped and title and risk of loss transfer to the customer, in accordance with the terms specified in the arrangement, and the four above mentioned revenue recognition criteria are met.

We recognize revenues on sales to distributors based on the rights granted to these distributors in our distribution agreements. We have certain distributors who have been granted return rights and receive credits for changes in selling prices to end customers, the magnitude of which is not known at the time products are shipped to the distributor. The return rights granted to these distributors consist of limited stock rotation rights, which allow them to rotate up to 10% of the products in their inventory twice a year, as well as certain product return rights if the applicable distribution agreement is terminated. These distributors also receive price concessions because they resell our products to end customers at various negotiated price points which vary by end customer, product, quantity, geography and competitive pricing environments. When a distributor's resale is priced at a discount from the distributor's invoice price, we credit back to the distributor a portion of the distributor's original purchase price after the resale transaction is complete. Thus, a portion of the Deferred income on sales to distributors balance will be credited

back to the distributor in the future. Under these agreements, we defer recognition of revenue until the products are resold by the distributor, at which time our final net sales price is fixed and the distributor's right to return the products expires. At the time of shipment to these distributors, (i) we record a trade receivable at the invoiced selling price because there is a legally enforceable obligation from the distributor to pay us currently for product delivered, (ii) we relieve inventory for the carrying value of products shipped because legal title has passed

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to the distributor, and (iii) we record deferred revenue and deferred cost of inventory under the *Deferred income on sales to distributors* caption in the liability section of our consolidated balance sheets. We evaluate the deferred cost of inventory component of this account for possible impairment by considering potential obsolescence of products that might be returned to us and by considering the potential of resale prices of these products being below our cost. By reviewing deferred inventory costs in the manners discussed above, we ensure that any portion of deferred inventory costs that are not recoverable from future contractual revenue are charged to cost of sales as an expense. *Deferred income on sales to distributors* effectively represents the gross margin on sales to distributors, however, the amount of gross margin we recognize in future periods may be less than the originally recorded deferred income as a result of negotiated price concessions. In recent years, such concessions have exceeded 30% of list price on average. For detail of this account balance, see *Note 3 Supplemental Financial Statement Data* to our consolidated financial statements.

We recognize revenues from other distributors at the time of shipment and when title and risk of loss transfer to the distributor, in accordance with the terms specified in the arrangement, and when the four above mentioned revenue recognition criteria are met. These distributors may also be given business terms to return a portion of inventory, however they do not receive credits for changes in selling prices to end customers. At the time of shipment, product prices are fixed and determinable and the amount of future returns can be reasonably estimated and accrued.

Revenue from the sale and license of intellectual property is recognized when the above mentioned four revenue recognition criteria are met. Development revenue is recognized when services are performed and customer acceptance has been received and was not significant for any of the periods presented.

*Deferred Income Taxes* We have provided a full valuation allowance against our U.S federal and state deferred tax assets. If sufficient evidence of our ability to generate future U.S federal and/or state taxable income becomes apparent, we may be required to reduce our valuation allowance, resulting in income tax benefits in our statement of operations. We evaluate the realizability of our deferred tax assets and assess the need for a valuation allowance quarterly.

*Impairment of Long-Lived Assets* We regularly monitor and review long-lived assets, including fixed assets, goodwill and intangible assets, for impairment including whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. The determination of recoverability is based on an estimate of the undiscounted cash flows expected to result from the use of an asset and its eventual disposition. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors. Our estimates of undiscounted cash flows may differ from actual cash flows due to, among other things, technological changes, economic conditions, changes to our business model or changes in our operating performance. If the sum of the undiscounted cash flows (excluding interest) is less than the carrying value, we recognize an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

## **Recent Accounting Pronouncements**

In September 2006, the FASB issued Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurement*, which defines fair value, establishes a framework for measuring fair value and expands disclosures regarding assets and liabilities measured at fair value. In February 2008, the FASB issued FASB Staff Position (FSP) 157-1,

*Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* (FSP 157-1) and FSP 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2010. The measurement and disclosure requirements related to financial assets and financial liabilities are effective for us in the

first quarter of fiscal 2009. The adoption of SFAS 157 for financial assets and financial liabilities is not expected to have a material impact on our results of operations or financial position. We are currently assessing the

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impact that SFAS 157 will have on our results of operations and financial position when it is applied to nonfinancial assets and nonfinancial liabilities beginning in the first quarter of fiscal 2010.

In February 2007, the FASB issued Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The statement permits entities to choose to measure many financial instruments and certain other items at fair value that are currently not required to be measured at fair value. We will be required to adopt SFAS 159 in the first quarter of fiscal 2009 and do not expect that the adoption will have a material impact on our financial condition or results of operations.

In June 2007, the FASB ratified Emerging Issues Task Force consensus on EITF Issue No. 07-3, *Accounting for Non-refundable Advanced Payments for Goods or Services to be Used in Future Research and Development Activities*. EITF Issue No. 07-3 requires that these payments be deferred and capitalized and expensed as goods are delivered or as the related services are performed. We will be required to adopt EITF 07-3 in the first quarter of fiscal 2009 and do not expect that the adoption will have a material impact on our financial condition or results of operations.

In December 2007, the FASB issued Financial Accounting Standards (SFAS) No. 141R, *Business Combinations*, and SFAS No. 160, *Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements*, an Amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). These new standards will significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. These Statements are effective for fiscal years beginning after December 15, 2008. We will be required to adopt SFAS No. 141R and SFAS No. 160 in the first quarter of fiscal 2010. Accordingly, to the extent we engage in any business combination transactions, such transactions will be recorded and disclosed following existing accounting principles until October 2, 2009.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an Amendment of FASB Statement No. 133. This Statement requires enhanced disclosures about an entity's derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We will be required to adopt SFAS 161 in the first quarter of fiscal 2010 and do not expect that the adoption will have a material impact on our financial condition or results of operations.

In May 2008, the FASB issued FASB Staff Position FSP APB 14-1, *Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. This FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We will be required to adopt this FSP in the first quarter of fiscal 2010. Early adoption is not permitted. We believe this change in methodology will negatively affect our earnings and earnings per share as interest expense will be required to reflect the market rate of interest for nonconvertible debt. We are currently evaluating the magnitude of this impact on our financial condition and results of operations.

## **Results of Operations**

### **Net Revenues**

#### ***Fiscal 2008 Compared to Fiscal 2007; Fiscal 2007 Compared to Fiscal 2006***

The following table summarizes our net revenues:

	<b>2008</b>	<b>Change</b>	<b>2007</b>	<b>Change</b>	<b>2006</b>
	<b>(Dollars in millions)</b>				
Multiservice access DSP products	\$ 55.8	53%	\$ 36.3	(3)%	\$ 37.4
High-performance analog products	41.9	12%	37.5	(12)%	42.7
WAN communications products	63.0	17%	54.0	(3)%	55.8
Net revenues	\$ 160.7	26%	\$ 127.8	(6)%	\$ 135.9

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The 26% increase in our net revenues for fiscal 2008 is driven by an increase in revenues from leveraging our intellectual property portfolio by selling non-core patents, as well as an increase in product sales. During fiscal 2008, we recognized \$16.4 million from the sale of patents compared to \$2 million in fiscal 2007. The remaining \$18.5 million of the increase in revenues represents higher product shipments across each of our product families. Net revenues from our multiservice access products increased \$19.5 million, or 53%, reflecting a combination of increased sales volumes across our newer VoIP product families, including our multiservice access carrier and enterprise products, as well as an increase in revenues recorded on the sale of intellectual property. We believe we are benefiting from the increasing deployment of IP-based networks both in new network buildouts worldwide and the replacement of circuit-switched networks. Net revenues from our high-performance analog products increased \$4.4 million, or 12%, reflecting a benefit from increased demand for our switching and signal conditioning products. Net revenues from our WAN communications products increased \$9.0 million, or 17% reflecting a combination of sales of Ethernet products added to the WAN portfolio as a result of the acquisition of certain assets of Ample Communications in the fourth quarter of fiscal 2007, revenue recorded on the sale of intellectual property and increased shipments of our high-level data link controller (HDLC) devices. These benefits were partially offset by a decrease in demand for our products in access and metropolitan area network applications such as T/E carrier transmission products, synchronous optical networking applications and DSL transceivers.

The 6% decrease in our net revenues for fiscal 2007 compared to fiscal 2006 reflects lower sales volumes across each of our product families. Net revenues from our multiservice access DSP products decreased \$1.1 million, or 3%, reflecting a decrease in sales in our legacy products mostly offset by increased sales volumes across our newer VoIP product families as well as \$2 million in revenues recorded on the sale of intellectual property. We experienced increased sales volumes of our newer VoIP product families, as telecommunication service providers install equipment to transmit their voice traffic over IP data networks. Net revenues from our high-performance analog products decreased by \$5.2 million, or 12%, mostly due to decreased shipments of our physical media dependent devices serving fiber optic markets somewhat offset by increased shipments of video infrastructure products serving standard and high definition broadcast video markets. Sales of our WAN communications products decreased by \$1.8 million, or 3%, primarily resulting from a slowdown in consumption of our products in access and metropolitan area network applications such as T/E carrier transmission products. These decreases were partially offset by an increase in demand for our ATM/MPLS network processor products for use in wireless, enterprise and broadband infrastructure applications.

**Gross Margin**

	2008	Change	2007	Change	2006
	(Dollars in millions)				
Gross margin	\$ 113.1	32%	\$ 85.5	(7)%	\$ 92.3
Percent of net revenues	70%		67%		68%

Gross margin represents net revenues less cost of goods sold. As a fabless semiconductor company, we use third parties (including TSMC, Jazz and Amkor) 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 fiscal 2008 increased \$27.6 million over fiscal 2007. \$14.3 million of this increase in gross margin is due to an increase in non-core patent sales with associated revenues growing from \$2 million in fiscal 2007 to \$16.4 million in fiscal 2008. Additionally, our gross margin for fiscal 2008 increased as a result of increased



product sales. Our gross margin as a percent of net product revenues for fiscal 2008 increased 1% from fiscal 2007 primarily as a result of a change in the provision for excess and obsolete inventories. The provision decreased \$0.9 million net for fiscal 2008 compared to an increase in the provision of \$1.8 million in fiscal 2007. These benefits were partially offset by a \$2.4 million reduction in the benefit related to the sale of inventory previously written down to a zero cost basis in 2001. Our gross margin for fiscal 2007 decreased \$6.8 million over fiscal 2006, principally reflecting the 6% decrease in our net revenues. Our gross margin as a percent of net revenues for fiscal 2007 decreased 1% from fiscal 2006 primarily as a result of a \$1.5 million reduction in the benefit related to the sale of inventory previously written down to a zero cost basis in 2001. In addition, the change in provision for

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excess and obsolete inventories was an increase in the provision of \$1.8 million in fiscal 2007 compared to a net decrease of \$0.6 million for fiscal 2006.

Our gross margin benefited from the sale of inventories with an original cost of \$1.6 million (fiscal 2008), \$4.0 million (fiscal 2007), and \$5.5 million (fiscal 2006) 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.

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. 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 twelve 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 October 3, 2008, we scrapped a portion of these inventories having an original cost of \$39.9 million and sold a portion of these inventories with an original cost of \$37.6 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 October 3, 2008, we continued to hold inventories with an original cost of \$6.0 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 continue to experience a 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 margin 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.

**Research and Development**

	<b>2008</b>	<b>Change</b>	<b>2007</b>	<b>Change</b>	<b>2006</b>
		<b>(Dollars in millions)</b>			
Research and development expenses	\$ 56.2	(2)%	\$ 57.4	(10)%	\$ 64.1
Percent of net revenues	35%		45%		47%

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Our research and development (R&D) expenses consist principally of direct personnel costs, photomasks, electronic design automation tools and pre-production evaluation and test costs. The \$1.2 million decrease in R&D expenses from fiscal 2008 to fiscal 2007 principally reflects a \$1.1 million decrease in depreciation expense, principally resulting from certain assets reaching the end of their depreciable lives. In addition, the decrease in R&D expenses reflects a \$0.6 million decrease in compensation and personnel-related costs, including stock compensation, resulting from our expense reduction actions and a \$0.6 million decrease in the cost of our facilities. These decreases in R&D were partially offset by a \$0.8 million increase in employee separation costs which consist of severance benefits payable to certain former employees as a result of organizational changes.

The \$6.7 million decrease in R&D expenses from fiscal 2007 to fiscal 2006 principally reflects a \$4.0 million decrease in compensation and personnel-related costs and a \$0.5 million decrease in the cost of our facilities resulting from our expense reduction actions. The decrease in R&D expenses also reflects a \$1.4 million decrease in depreciation expense, principally resulting from certain assets reaching the end of their depreciable lives, and a \$0.6 million decrease in the cost of materials, photomasks and preproduction devices.

**Selling, General and Administrative**

	2008	Change	2007	Change	2006
	(Dollars in millions)				
Selling, general and administrative expenses	\$ 47.0	8%	\$ 43.4	(8)%	\$ 47.0
Percent of net revenues	29%		34%		35%

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. The \$3.6 million increase in our SG&A expenses for fiscal 2008 compared to fiscal 2007 reflects an increase of approximately \$0.3 million, net in labor and benefits, including stock compensation, due to an increase in the cost of benefits offered to our employees, as well as \$0.9 million in employee separation costs which consist of severance benefits payable to certain former employees as a result of organizational changes. Additionally, we experienced a \$1.7 million increase in professional fees. The increase in professional fees is primarily due to expenses incurred in conjunction with business development activities and effecting a reverse stock split.

The \$3.6 million decrease in our SG&A expenses for fiscal 2007 compared to fiscal 2006 reflects a \$1.3 million decrease in personnel-related costs and a \$0.6 million decrease in the cost of our facilities, all of which are a result of our expense reduction actions. In addition, insurance costs decreased \$0.4 million and commissions expense decreased \$0.8 million as a result of a reduction in the usage of outside sales representatives.

**Special Charges**

Special charges consist of the following:

	2008	2007	2006
	(In millions)		
Restructuring charges	\$ 0.2	\$ 4.7	\$ 2.6

*Mindspeed Restructuring Plans* In fiscal 2006 and 2007, we implemented a number of cost reduction initiatives to improve our 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.

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Activity and liability balances related to the Mindspeed restructuring plans through October 3, 2008 are as follows (in thousands):

	<b>Workforce Reductions</b>	<b>Facility and Other</b>	<b>Total</b>
Restructuring balance, September 29, 2006	\$ 953	\$ 714	\$ 1,667
Charged to costs and expenses	2,191	2,533	4,724
Non cash charges	(61)		(61)
Cash payments	(2,851)	(1,995)	(4,846)
Restructuring balance, September 28, 2007	232	1,252	1,484
Charged to costs and expenses	(40)	251	211
Non cash charges		(71)	(71)
Cash payments	(186)	(1,430)	(1,616)
Restructuring balance, October 3, 2008	\$ 6	\$ 2	\$ 8

In the first quarter of fiscal 2009, we announced a restructuring plan. We anticipate incurring special charges of between \$2.7 and \$3.2 million dollars during the first and second quarters of fiscal 2009, primarily associated with severance costs for affected employees. When we complete these restructuring actions, we estimate we will achieve annualized savings of between \$4.6 and \$5.1 million dollars.

**Interest Expense**

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In millions)</b>		
Interest expense	\$ (2.4)	\$ (2.2)	\$ (2.2)

Interest expense for fiscal 2008, 2007 and 2006 represents interest on our convertible senior notes issued in December 2004 and July 2008. The interest expense increase for fiscal 2008, as compared to fiscal 2007, is a result of our extinguishment and reissuance of \$15 million of our convertible notes which occurred in July of 2008. The interest rate on these convertible senior notes increased from 3.75% to 6.5%.

**Other Income, Net**

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In millions)</b>		
Other income, net	\$ 0.5	\$ 0.5	\$ 0.9

Other income principally consists of interest income, foreign exchange gains and losses, franchise taxes and other non-operating gains and losses. The decrease in other income in fiscal 2007 as compared to fiscal 2006 principally reflects lower interest income resulting from the lower cash, cash equivalent and marketable security balances.

**Provision for Income Taxes**

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In millions)</b>		
Provision for income taxes	\$ 0.6	\$ 0.1	\$ 1.8

Our provision for income taxes for fiscal years 2008, 2007 and 2006 principally consisted of income taxes incurred by our foreign subsidiaries. As a result of our recent operating losses and the potential of future operating results, we determined that it is more likely than not that the U.S. federal and state income tax benefits (principally net operating losses we can carry forward to future years) which arose during fiscal 2008, 2007, and 2006 will not be realized. Accordingly, we have not recognized any income tax benefits relating to our U.S. federal and state 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 2009 will principally consist of income taxes related to our foreign operations.

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As of October 3, 2008, we had a valuation allowance of \$248.3 million against our U.S. federal and state deferred tax assets (which reduces their carrying value to zero) because we do not expect to realize these deferred tax assets through the reduction of future income tax payments. As of October 3, 2008, we had U.S. federal net operating loss carryforwards of approximately \$630.9 million, including the net operating loss carryforwards we retained in the distribution.

## **Liquidity and Capital Resources**

Cash generated by operating activities was \$26.7 million for fiscal 2008 compared to cash used in operating activities of \$10.0 million for fiscal 2007 and \$15.9 million for fiscal 2006. Operating cash flows for fiscal 2008 reflect our net income of \$7.2 million, non-cash charges (depreciation, stock compensation, inventory provisions and other) of \$11.8 million, and net working capital decreases of approximately \$7.6 million. Operating cash flows for fiscal 2007 reflect our net loss of \$21.9 million, partially offset by non-cash charges (depreciation, stock compensation, inventory provisions and other) of \$14.8 million, and net working capital increases of approximately \$2.9 million.

The net working capital decreases for fiscal 2008 included a \$5.4 million increase in accounts payable, a \$1.1 million increase in accrued expenses and other current liabilities mainly due to the timing of vendor payments. These amounts were partially offset by a \$0.3 million increase in inventories.

Cash used in investing activities of \$8.7 million consisted of capital expenditures of \$7.5 million and cash payments related to the acquisition of assets from Ample Communications of \$1.2 million. Cash provided by investing activities of \$2.3 million for fiscal 2007 consisted of net sales of marketable securities (net of purchases) of \$11.3 million, partially offset by capital expenditures of \$4.1 million and the acquisition of assets from Ample Communications of \$4.9 million. Cash provided by investing activities of \$25.2 million for fiscal 2006 principally consisted of net sales of marketable securities (net of purchases) of \$29.7 million, partially offset by capital expenditures of \$4.5 million.

Cash used in financing activities of \$0.7 million for fiscal 2008 consisted of \$0.8 million in debt issuance costs related to our new 6.5% senior convertible debt partially offset by proceeds from the exercise of stock options of \$0.1 million. Cash provided by financing activities of \$3.4 million for fiscal 2007 consisted of proceeds from the exercise of stock options. Cash provided by financing activities of \$5.3 million for fiscal 2006 consisted of proceeds from the exercise of stock options.

## ***Revolving Credit Facility and Convertible Senior Notes***

### ***Revolving Credit Facility***

On September 30, 2008, we entered into a loan and security agreement with Silicon Valley Bank, or SVB. Under the loan and security agreement, SVB has agreed to provide us with a three-year revolving credit line of up to \$15.0 million, subject to availability against certain eligible accounts receivable, for the purposes of (i) working capital; (ii) funding our general business requirements; and (iii) repaying or repurchasing our 3.75% Convertible Senior Notes due in 2009. Our indebtedness to SVB under the loan and security agreement is guaranteed by three of our domestic subsidiaries and secured by substantially all of the domestic assets of the company and such subsidiaries, other than intellectual property.

Any indebtedness under the loan and security agreement bears interest at a variable rate ranging from prime plus 0.25 percent to a maximum rate of prime plus 1.25 percent, as determined in accordance with the interest rate grid set forth in the loan and security agreement. The loan and security agreement contains affirmative and negative covenants which, among other things, require us to maintain a minimum tangible net worth and to deliver to SVB specified financial information, including annual, quarterly and monthly financial information, and limit our ability to (or to



permit any subsidiaries to), subject to certain exceptions and limitations: (i) merge with or acquire other companies; (ii) create liens on our property; (iii) incur debt obligations; (iv) enter into transactions with affiliates, except on an arm's length basis; (v) dispose of property; and (vi) issue dividends or make distributions.

As of October 3, 2008, we were in compliance with all required covenants. At October 3, 2008, we had no outstanding borrowings under our credit facility with SVB.

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*3.75% Convertible Senior Notes due 2009*

In December 2004, we sold an aggregate principal amount of \$46.0 million in convertible senior notes due 2009, of which only \$10.5 million is currently outstanding, for net proceeds (after discounts and commissions) of approximately \$43.9 million. The notes are senior unsecured obligations, ranking equal in right of payment with all future unsecured indebtedness. The notes bear interest at a rate of 3.75%, payable semiannually in arrears each May 18 and November 18. The notes are due November 18, 2009. We used approximately \$3.3 million of the proceeds to purchase U.S. government securities that were pledged to the trustee for the payment of the first four scheduled interest payments on the notes when due.

The notes are convertible, at the option of the holder, at any time prior to maturity into shares of our common stock. Upon conversion, we may, at our option, elect to deliver cash in lieu of shares of our common stock or a combination of cash and shares of common stock. Effective May 13, 2005, the conversion price of the notes was adjusted to \$11.55 per share (\$2.31 per share on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock, which is equal to a conversion rate of approximately 86.58 shares (432.9004 shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock per \$1,000 principal amount of notes. Prior to this adjustment, the conversion price applicable to the notes was \$14.05 per share (\$2.81 per share on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock, which was equal to approximately 71.17 shares (355.8719 shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock per \$1,000 principal amount of notes. The adjustment was made pursuant to the terms of the indenture governing the notes. The conversion price is subject to further adjustment under the terms of the indenture to reflect stock dividends, stock splits, issuances of rights to purchase shares of common stock and certain other events.

If we undergo certain fundamental changes (as defined in the indenture), holders of notes may require us to repurchase some or all of their notes at 100% of the principal amount plus accrued and unpaid interest. If, upon notice of certain events constituting a fundamental change, holders of the notes elect to convert the notes, we may be required to make an additional cash payment per \$1,000 principal amount of notes in connection with the conversion. The amount of the additional cash payment, if any, will be determined by reference to a table set forth in the indenture governing the notes and our average stock price (as determined in accordance with the indenture) for the 20 trading days following the conversion date. If an applicable fundamental change were to occur between November 18, 2008 and November 18, 2009, the amount of the additional cash payment would be equal to such average stock price times a multiplier of up to 11.95 (59.75 on a pre-June 30, 2008 one-for-five reverse stock split basis). Our obligation to make the additional cash payment will not apply to fundamental changes that occur on or after November 18, 2009, and the applicable multiplier will decrease on a daily basis through that date. Notwithstanding the foregoing, no additional cash payment will be required if the applicable average stock price is less than \$11.50 per share (\$2.30 per share on a pre-June 30, 2008 one-for-five reverse stock split basis) (subject to adjustment as set forth in the indenture). In the event of a non-stock change of control constituting a public acquirer change of control (as defined in the indenture), we may, in lieu of making an additional cash payment upon conversion as required by the indenture, elect to adjust the conversion price and the related conversion obligation such that the noteholders will be entitled to convert their notes into a number of shares of public acquirer common stock.

For financial accounting purposes, our contingent obligation to issue additional shares or make additional cash payment upon conversion following a fundamental change is an embedded derivative. As of October 3, 2008, the liability under the fundamental change adjustment has been recorded at its estimated fair value and is not significant.

On July 30, 2008, we entered into separate exchange agreements with certain holders of our existing convertible senior notes due 2009, pursuant to which holders of an aggregate of \$15 million of the existing notes agreed to exchange their notes for \$15 million in aggregate principal amount of a new series of convertible senior notes due 2013. The exchanges closed on August 1, 2008. We paid at the closing an aggregate of approximately \$0.1 million in

accrued and unpaid interest on the existing notes that were exchanged for the new notes, as well as \$0.9 million in transaction fees.

In October 2008, we repurchased \$20.5 million aggregate principal amount of our convertible senior notes due 2009, for cash of \$17.3 million. The repurchases occurred in two separate transactions on October 16 and October 23, 2008.

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*6.50% Convertible Senior Notes due 2013*

We issued the convertible senior notes due 2013, or new notes, pursuant to an indenture, dated as of August 1, 2008, between us and Wells Fargo Bank, N.A., as trustee.

The new notes are unsecured senior indebtedness and bear interest at a rate of 6.50% per annum. Interest is payable on February 1 and August 1 of each year, commencing on February 1, 2009. The new notes mature on August 1, 2013. At maturity, we will be required to repay the outstanding principal of the new notes.

The new notes are convertible at the option of the holders, at any time on or prior to maturity, into shares of our common stock at a conversion rate initially equal to approximately \$4.74 per share of common stock, which is subject to adjustment in certain circumstances. Upon conversion of the new notes, we generally have the right to deliver to the holders thereof, at our option: (i) cash; (ii) shares of our common stock; or (iii) a combination thereof. The initial conversion price of the new notes will be adjusted to reflect stock dividends, stock splits, issuances of rights to purchase shares of our common stock, and upon other events. If we undergo certain fundamental changes prior to maturity of the new notes, the holders thereof will have the right, at their option, to require us to repurchase for cash some or all of their new notes at a repurchase price equal to 100% of the principal amount of the new notes being repurchased, plus accrued and unpaid interest (including additional interest, if any) to, but not including, the repurchase date, or convert the new notes into shares of our common stock and, under certain circumstances, receive additional shares of our common stock in the amount provided in the indenture.

For financial accounting purposes, our contingent obligation to issue additional shares or make additional cash payment upon conversion following a fundamental change is an embedded derivative. As of October 3, 2008, the liability under the fundamental change adjustment has been recorded at its estimated fair value and is not significant.

If there is an event of default under the new notes, the principal of and premium, if any, on all the new notes and the interest accrued thereon may be declared immediately due and payable, subject to certain conditions set forth in the indenture. An event of default under the indenture will occur if we: (i) are delinquent in making certain payments due under the new notes; (ii) fail to deliver shares of common stock or cash upon conversion of the new notes; (iii) fail to deliver certain required notices under the new notes; (iv) fail, following notice, to cure a breach of a covenant under the new notes or the indenture; (v) incur certain events of default with respect to other indebtedness; or (vi) is subject to certain bankruptcy proceedings or orders. If we fail to deliver certain SEC reports to the trustee in a timely manner as required by the indenture, (x) the interest rate applicable to the new notes during the delinquency will be increased by 0.25% or 0.50%, as applicable (depending on the duration of the delinquency), and (y) if the required reports are not delivered to the trustee within 180 days after their due date under the indenture, a holder of the new notes will generally have the right, subject to certain limitations, to require us to repurchase all or any portion of the new notes then held by such holder.

***Conexant Warrant***

On June 27, 2003, Conexant Systems, Inc. completed the distribution to Conexant stockholders of all 18,066,689 (90,333,445 on a pre-June 30, 2008 one-for-five reverse stock split basis) outstanding shares of common stock of our company, its wholly owned subsidiary. In the distribution, each Conexant stockholder received one fifth of one share (one share on a pre-June 30, 2008 one-for-five reverse stock split basis) of our common stock (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.

In the distribution, we issued to Conexant a warrant to purchase six million shares (30 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of our common stock at a price of \$17.04 per share (\$3.408 on a pre-June 30, 2008 one-for-five reverse stock split basis), exercisable for a period of ten years after the distribution.

The warrant may be transferred or sold in whole or part at any time. The warrant contains antidilution provisions that provide for adjustment of the exercise price, and the number of shares issuable under the warrant, upon the occurrence of certain events. If we issue, or are deemed to have issued, shares of our common stock, or securities convertible into our common stock, at prices below the current market price of our common stock (as defined in the

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warrants) at the time of the issuance of such securities, the warrant's exercise price will be reduced and the number of shares issuable under the warrant will be increased. The amount of such adjustment if any, will be determined pursuant to a formula specified in the warrant and will depend on the number of shares issued, the offering price and the current market price of our common stock at the time of the issuance of such securities. Adjustments to the warrant pursuant to these antidilution provisions may result in significant dilution to the interests of our existing stockholders and may adversely affect the market price of our common stock. The antidilution provisions may also limit our ability to obtain additional financing on terms favorable to us.

Moreover, we may not realize any cash proceeds from the exercise of the warrant held by Conexant. A holder of the warrant may opt for a cashless exercise of all or part of the warrant. In a cashless exercise, the holder of the warrant would make no cash payment to us and would receive a number of shares of our common stock having an aggregate value equal to the excess of the then-current market price of the shares of our common stock issuable upon exercise of the warrant over the exercise price of the warrant. Such an issuance of common stock would be immediately dilutive to the interests of other stockholders.

***Liquidity***

Our principal sources of liquidity are our existing cash and cash equivalent balances and cash generated from product sales and the sales of our non-core intellectual property. As of October 3, 2008, our cash and cash equivalents totaled \$43.0 million. Our working capital at October 3, 2008 was \$50.3 million.

In order to sustain profitability and positive cash flows from operations, we may need to further reduce operating expenses and/or maintain increased revenues. Through fiscal 2008, we have completed a series of cost reduction actions which have improved our operating cost structure. These expense reductions alone may not allow us to sustain the profitability we achieved in the fourth quarter of fiscal 2008. Our ability to achieve the necessary revenue growth will depend on increased demand for network infrastructure equipment that incorporates our products, which in turn depends primarily on the level of capital spending by communications service providers and enterprises the level of which may decrease due to general economic conditions, and uncertainty, over which we have no control. We may not be successful in achieving the necessary revenue growth or we may be unable to sustain past and future expense reductions in subsequent periods. We may not be able to sustain profitability.

We believe that our existing sources of liquidity, along with cash expected to be generated from product sales and the sales of non-core intellectual property, 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, including the repayment of the remaining \$10.5 million in senior convertible debt due in November 2009. From time to time, we may acquire our debt securities through privately negotiated transactions, tender offers, exchange offers (for new debt or other securities), redemptions or otherwise, upon such terms and at such prices as we may determine appropriate. We will need to continue a focused program of capital expenditures 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 debt or equity financing. We may also need to seek to obtain additional debt or equity financing if we experience downturns or cyclical fluctuations in our business that are more severe or longer than anticipated or if we fail to achieve anticipated revenue and expense levels. However, we cannot assure you that such financing will be available to us on favorable terms, or at all particularly in light of recent economic conditions in the capital markets.

**Table of Contents****Contractual Obligations**

The following table summarizes the future payments we are required to make under contractual obligations as of October 3, 2008:

Contractual Obligations	Total	Payments Due by Period			
		<1 Year	1-3 Years	3-5 Years	>5 Years
			(In millions)		
Long-term debt	\$ 46.0	\$	\$ 31.0	\$ 15.0	\$
Interest expense on long-term debt	6.6	2.1	2.5	2.0	
Operating leases	16.3	7.7	6.7	1.5	0.4
Purchase obligations	7.6	3.1	4.5		
Employee severance	0.9	0.8	0.1		
Total	\$ 77.4	\$ 13.7	\$ 44.8	\$ 18.5	\$ 0.4

Long-term debt consists of \$46.0 million aggregate principal amount of our convertible senior notes. \$31.0 million of the notes bear interest at a rate of 3.75%, payable semiannually in arrears each May 18 and November 18, and mature on November 18, 2009. During October 2009, we repurchased \$20.5 million of these notes. The remaining \$15.0 million of the notes bear interest at a rate of 6.5%, payable semiannually in arrears each February 1 and August 1, and mature on August 1, 2013.

In June 2007, we extended our Sublease with Conexant pursuant to which we lease our headquarters in Newport Beach, California. The Sublease, which had been amended and restated in March 2005, had an initial term through June 2008. The Sublease was extended for an additional two year term (through June 2010) for a reduced amount of space. Rent payable under the Sublease for the next 12 months is approximately \$3.4 million. Rent payable is subject to annual increases of 3%, plus a prorated portion of operating expenses associated with the leased property. We estimate our minimum future obligation under the Sublease at approximately \$10.2 million over the remainder of the lease term, but actual costs under the Sublease will vary based upon Conexant's actual costs. In addition, each year we may elect to purchase certain services from Conexant based on a prorated portion of Conexant's actual costs.

We lease our other facilities and certain equipment under non-cancelable operating leases. The leases expire at various dates through 2014 and contain various provisions for rental adjustments, including, in certain cases, adjustments based on increases in the Consumer Price Index. The leases generally contain renewal provisions for varying periods of time. Although we have entered into non-cancelable subleases with anticipated rental income totaling \$0.9 million and extending to various dates through fiscal 2011, we have not reduced the amount of our contractual obligations under the related operating leases to take into account the anticipated rental income.

Purchase obligations are comprised of commitments to purchase design tools and software for use in product development, which will be spent between fiscal 2009 and fiscal 2012. We have not included open purchase orders for inventory or other expenses issued in the normal course of business in the purchase obligations shown above.

In addition to the obligations included in the table above, we have a \$0.4 million liability related to post-retirement benefits for employees at one of our international locations. The timing of the related payments is not known.

**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 stockholders. 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



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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.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Our cash and cash equivalents consist of commercial paper and highly-liquid money market funds. 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 that meet high credit quality standards and we limit the amount of our credit exposure to any one issuer. We do not use derivative instruments for speculative or investment purposes.

**Interest Rate Risk**

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities or variable interest rate characteristics of these instruments. As of October 3, 2008, the carrying value of our cash and cash equivalents approximates fair value.

Our long-term debt consists of our revolving credit facility and our convertible senior notes. Our convertible senior notes bear interest at fixed rates of 3.75% and 6.5%. Consequently, our results of operations and cash flows are not subject to any significant interest rate risk relating to our convertible senior notes. Advances under our credit facility bear interest at a variable rate ranging from prime plus 0.25 percent to a maximum rate of prime plus 1.25 percent, as determined in accordance with the interest rate grid set forth in the loan and security agreement. If the prime rate increased, thereby increasing our effective borrowing rate by the same amount, cash interest expense related to the credit facility would increase dependent on any outstanding borrowings. There were no borrowings on the credit facility during fiscal 2008.

**Foreign Exchange Risk**

We transact business in various foreign currencies and we face foreign exchange risk on assets and liabilities that are denominated in foreign currencies. The majority of our foreign exchange risks are not hedged; however, from time to time, we may utilize foreign currency forward exchange contracts to hedge a portion of our exposure to foreign exchange risk. These hedging transactions are intended to offset the gains and losses we experience on foreign currency transactions with gains and losses on the forward contracts, so as to mitigate our overall risk of foreign exchange gains and losses. We do not enter into forward contracts for speculative or trading purposes. At October 3, 2008, we held no foreign currency forward exchange contracts. Based on our overall currency rate exposure at October 3, 2008, a 10% change in currency rates would not have a material effect on our consolidated financial position, results of operations or cash flows.

**Table of Contents****Item 8. Financial Statements and Supplementary Data****MINDSPEED TECHNOLOGIES, INC.****CONSOLIDATED BALANCE SHEETS**

	<b>October 3, 2008</b>	<b>September 28, 2007</b>
	<b>(In thousands, except share amounts)</b>	
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 43,033	\$ 25,796
Receivables, net of allowances for doubtful accounts of \$342 (2008) and \$353 (2007)	14,398	13,584
Inventories	16,187	15,023
Other current assets	3,138	3,763
Total current assets	76,756	58,166
Property, plant and equipment, net	12,600	13,147
Intangible assets, net	2,480	3,200
Goodwill	2,429	2,324
License agreements, net	3,347	1,798
Other assets	2,992	3,444
Total assets	\$ 100,604	\$ 82,079
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 11,265	\$ 7,117
Deferred income on sales to distributors	4,869	4,226
Accrued compensation and benefits	6,778	5,286
Accrued income tax	412	752
Restructuring	8	1,478
Other current liabilities	3,147	3,493
Total current liabilities	26,479	22,352
Convertible senior notes	45,648	45,037
Other liabilities	519	444
Total liabilities	72,646	67,833
Commitments and contingencies (Notes 6 and 7)		
<b>Stockholders Equity</b>		

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Preferred stock, \$0.01 par value: 25,000 shares authorized; no shares issued or outstanding		
Common stock, \$0.01 par value, 100,000 shares authorized; 23,852 (2008) and 23,152 (2007) issued shares(1)	239	232
Additional paid-in capital(1)	269,487	263,427
Accumulated deficit	(227,043)	(234,480)
Accumulated other comprehensive loss	(14,725)	(14,933)
Total stockholders' equity	27,958	14,246
Total liabilities and stockholders' equity	\$ 100,604	\$ 82,079

(1) Common stock and additional paid in capital amounts have been retroactively adjusted to reflect the effect of the Company's June 30, 2008 one-for-five reverse stock split. See Note 1.

See accompanying notes to consolidated financial statements.

**Table of Contents****MINDSPEED TECHNOLOGIES, INC****CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>October 3, 2008</b>	<b>Sept. 28, 2007</b>	<b>Sept. 29, 2006</b>
	<b>(In thousands, except per share amounts)</b>		
Net revenues:			
Products	\$ 144,349	\$ 125,805	\$ 135,919
Intellectual Property	16,350	2,000	
Total net revenues	160,699	127,805	135,919
Cost of goods sold	47,625	42,334	43,592
Gross margin	113,074	85,471	92,327
Operating expenses:			
Research and development	56,217	57,447	64,104
Selling, general and administrative	46,984	43,385	46,970
Special charges	211	4,724	2,550
Total operating expenses	103,412	105,556	113,624
Operating gain/(loss)	9,662	(20,085)	(21,297)
Interest expense	(2,360)	(2,240)	(2,231)
Other income, net	544	522	863
Income/(loss) before income taxes	7,846	(21,803)	(22,665)
Provision for income taxes	611	111	1,849
Net income/(loss)	\$ 7,235	\$ (21,914)	\$ (24,514)
Income/(loss) per share:			
Income/(loss) per share, basic(1)	\$ 0.31	\$ (0.99)	\$ (1.16)
Income/(loss) per share, diluted(1)	\$ 0.31	\$ (0.99)	\$ (1.16)
Shares used in computation of net income/(loss) per share, in thousands:			
Basic(1)	23,046	22,156	21,107
Diluted(1)	23,202	22,156	21,107

(1) Share and per share amounts have been adjusted to reflect the Company's one-for-five stock split which occurred on June 30, 2008. See Note 1.

See accompanying notes to consolidated financial statements.



**Table of Contents****MINDSPEED TECHNOLOGIES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>October 3, 2008</b>	<b>Sept. 28, 2007</b>	<b>Sept. 29, 2006</b>
	<b>(In thousands)</b>		
<b>Cash Flows From Operating Activities</b>			
Net income/(loss)	\$ 7,235	\$ (21,914)	\$ (24,514)
Adjustments required to reconcile net income/(loss) to net cash provided by/(used in) operating activities:			
Depreciation and amortization	7,173	5,681	6,977
Provision for bad debts	(12)	(131)	(15)
Inventory provisions	(900)	1,790	(586)
Stock compensation	5,506	7,301	7,516
Other noncash items, net	79	176	(51)
Changes in assets and liabilities, net of effects of acquisitions:			
Receivables	(741)	1,361	1,585
Inventories	(264)	2,554	(7,692)
Accounts payable	5,380	(5,096)	863
Deferred income on sales to distributors	646	(177)	986
Accrued expenses and other current liabilities	1,076	(1,398)	274
Other	1,517	(189)	(1,223)
Net cash provided by/(used in) operating activities	26,695	(10,042)	(15,880)
<b>Cash Flows From Investing Activities</b>			
Capital expenditures	(7,514)	(4,074)	(4,488)
Acquisition of assets, net of cash acquired	(1,172)	(4,875)	
Purchases of available-for-sale marketable securities		(15,682)	(37,597)
Sales of available-for-sale marketable securities		26,100	65,585
Maturities of held-to-maturity marketable securities		863	1,725
Net cash provided by/(used in) investing activities	(8,686)	2,332	25,225
<b>Cash Flows From Financing Activities</b>			
Exercise of stock options and warrants	111	3,412	5,296
Deferred financing costs	(805)		
Net cash provided by/(used in) financing activities	(694)	3,412	5,296
Effect of foreign currency exchange rates on cash	(78)	118	
Net increase/(decrease) in cash and cash equivalents	17,237	(4,180)	14,641
Cash and cash equivalents at beginning of period	25,796	29,976	15,335
Cash and cash equivalents at end of period	\$ 43,033	\$ 25,796	\$ 29,976

See accompanying notes to consolidated financial statements.

**Table of Contents****MINDSPEED TECHNOLOGIES, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND  
COMPREHENSIVE LOSS**

	<b>Common Stock(1) Shares</b>	<b>Common Stock(1) Amount</b>	<b>Additional Paid-in Capital(1)</b>	<b>Accumulated Deficit</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total Stockholders Equity</b>
	<b>(In thousands)</b>					
Balance at September 30, 2005	20,770	\$ 208	\$ 237,834	\$ (188,052)	\$ (16,164)	\$ 33,826
Net loss				(24,514)		(24,514)
Currency translation adjustments					497	497
Comprehensive loss						(24,017)
Common stock repurchased and retired	(23)		(259)			(259)
Issuance of common stock	1,370	14	6,396			6,410
Compensation expense related to employee stock plans	23		7,516			7,516
Balance at September 29, 2006	22,140	222	251,487	(212,566)	(15,667)	23,476
Net loss				(21,914)		(21,914)
Currency translation adjustments					734	734
Comprehensive loss						(21,180)
Issuance of common stock	1,018	10	4,702			4,712
Common stock repurchased and retired	(6)		(63)			(63)
Compensation expense related to employee stock plans			7,301			7,301
Balance at September 28, 2007	23,152	232	263,427	(234,480)	(14,933)	14,246
Cumulative effect of adopting FIN 48				202		202
Balance at September 28, 2007	23,152	232	263,427	(234,278)	(14,933)	14,448
Net income				7,235		7,235
Currency translation adjustments					208	208
Comprehensive income						7,443
Issuance of common stock	700	7	558			565
Common stock repurchased and retired			(4)			(4)



Compensation expense related to employee stock plans				5,506				5,506
Balance at October 3, 2008	23,852	\$ 239	\$ 269,487	\$ (227,043)	\$ (14,725)	\$		27,958

- (1) Common stock and additional paid in capital amounts have been retroactively adjusted to reflect the effect of the Company's June 30, 2008 one-for-five reverse stock split. See Note 1.

See accompanying notes to consolidated financial statements.

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business**

Mindspeed Technologies, Inc. (Mindspeed or the Company) designs, develops and sells semiconductor networking solutions for communications applications in enterprise, broadband access, metropolitan and wide-area networks. On June 27, 2003, Conexant Systems, Inc. (Conexant) completed the distribution (the Distribution) to Conexant stockholders of all 18,066,689 (90,333,445 on a pre-June 30, 2008 one-for-five reverse stock split basis) outstanding shares of common stock of its wholly owned subsidiary, Mindspeed. In the Distribution, each Conexant stockholder received one fifth of a share (one share on a pre-June 30, 2008 one-for-five reverse stock split basis) of Mindspeed common stock (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 six million shares (30 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of Mindspeed common stock at a price of \$17.04 per share (\$3.408 on a pre-June 30, 2008 one-for-five reverse stock split basis), exercisable for a period beginning one year and ending ten years after the Distribution. In connection with the Distribution, Mindspeed and Conexant also entered into a Credit Agreement (terminated December 2004), an Employee Matters Agreement, a Tax Allocation Agreement, a Transition Services Agreement and a Sublease.

***Basis of Presentation***

The consolidated condensed financial statements, prepared in accordance with generally accepted accounting principles in the United States of America, include the accounts of Mindspeed and each of its subsidiaries. All accounts and transactions among Mindspeed and its subsidiaries have been eliminated in consolidation. In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments, consisting of adjustments of a normal recurring nature and the special charges (Note 12), necessary to present fairly the Company's financial position, results of operations and cash flows in accordance with generally accepted accounting principles in the United States of America.

***Reverse Stock Split***

In May 2008, the Company's Board of Directors approved a one-for-five reverse stock split following approval by the Company's stockholders on April 7, 2008. The reverse stock split was effected June 30, 2008. All share and per share amounts have been retroactively adjusted to reflect the reverse stock split. There was no net effect on total stockholders equity as a result of the reverse stock split.

***Liquidity***

In order to sustain profitability and positive cash flows from operations, the Company may need to further reduce operating expenses and/or maintain increased revenues. Through fiscal 2008, the Company has completed a series of cost reduction actions which have improved its operating cost structure. These expense reductions alone may not

allow the Company to sustain the profitability it achieved in the fourth quarter of fiscal 2008. The Company's ability to achieve the necessary revenue growth will depend on increased demand for network infrastructure equipment that incorporates its products, which in turn depends primarily on the level of capital spending by communications service providers and enterprises the level of which may decrease due to general economic conditions, and uncertainty, over which the Company has no control. The Company may not be successful in achieving the necessary revenue growth or it may be unable to sustain past and future expense reductions in subsequent periods. The Company may not be able to sustain profitability.

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company believes that its existing sources of liquidity, along with cash expected to be generated from product sales and the sales of non-core intellectual property, will be sufficient to fund its operations, research and development efforts, anticipated capital expenditures, working capital and other financing requirements for at least the next twelve months, including the repayment of the remaining \$10.5 million in senior convertible debt due in November 2009. From time to time, the Company may acquire its debt securities through privately negotiated transactions, tender offers, exchange offers (for new debt or other securities), redemptions or otherwise, upon such terms and at such prices as the Company may determine appropriate. The Company will need to continue a focused program of capital expenditures to meet its research and development and corporate requirements. The Company may also consider acquisition opportunities to extend its technology portfolio and design expertise and to expand its product offerings. In order to fund capital expenditures, increase its working capital or complete any acquisitions, the Company may seek to obtain additional debt or equity financing. The Company may also need to seek to obtain additional debt or equity financing if it experiences downturns or cyclical fluctuations in its business that are more severe or longer than anticipated or if it fails to achieve anticipated revenue and expense levels. However, the Company cannot assure you that such financing will be available on favorable terms, or at all particularly in light of recent economic conditions in the capital markets.

**2. Summary of Significant Accounting Policies**

*Fiscal Periods* The Company maintains a fifty-two/fifty-three week fiscal year ending on the Friday closest to September 30. Fiscal year 2008 comprised 53 weeks and ended on October 3, 2008. Fiscal year 2007 and 2006 comprised 52 weeks and ended on September 28 and September 29, respectively.

*Use of Estimates* The preparation of financial statements in conformity with generally accepted accounting principles requires management 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. Among the significant estimates affecting the Company's consolidated financial statements are those relating to inventories, revenue recognition, allowances for doubtful accounts, stock-based compensation, income taxes and impairment of long-lived assets. Management regularly evaluates our estimates and assumptions based upon historical experience and various other factors that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent actual results differ from those estimates, the Company's future results of operations may be affected.

*Revenue Recognition* The Company's products are often integrated with software that is essential to the functionality of the equipment. Additionally, the Company provides unspecified software upgrades and enhancements through its maintenance contracts for many of its products. Accordingly, the Company accounts for revenue in accordance with Statement of Position No. 97-2, Software Revenue Recognition, and all related interpretations. For sales of products where software is incidental to the equipment, the Company applies the provisions of Staff Accounting Bulletin No. 104, Revenue Recognition, and all related interpretations.

The Company generates revenues from direct product sales, sales to distributors, maintenance contracts, development agreements and the sale and license of intellectual property. The Company recognizes revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) our price to the customer is fixed or determinable; and (iv) collection of the sales price is reasonably assured. In instances

where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Technical support services revenue is deferred and recognized ratably over the period during which the services are to be performed. Advanced services revenue is recognized upon delivery or completion of performance.

Revenues are recognized on products shipped directly to customers at the time the products are shipped and title and risk of loss transfer to the customer, in accordance with the terms specified in the arrangement, and the four above mentioned revenue recognition criteria are met.

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Revenues are recognized on sales to distributors based on the rights granted to these distributors in the Distribution agreements. The Company has certain distributors who have been granted return rights and receive credits for changes in selling prices to end customers, the magnitude of which is not known at the time products are shipped to the distributor. The return rights granted to these distributors consist of limited stock rotation rights, which allow them to rotate up to 10% of the products in their inventory twice a year, as well as certain product return rights if the applicable distribution agreement is terminated. These distributors also receive price concessions because they resell the Company's products to end customers at various negotiated price points which vary by end customer, product, quantity, geography and competitive pricing environments. When a distributor's resale is priced at a discount from the distributor's invoice price, the Company credits back to the distributor a portion of the distributor's original purchase price after the resale transaction is complete. Thus, a portion of the Deferred income on sales to distributors balance will be credited back to the distributor in the future. Under these agreements, recognition of revenue is deferred until the products are resold by the distributor, at which time the Company's final net sales price is fixed and the distributor's right to return the products expires. At the time of shipment to these distributors, (i) a trade receivable at the invoiced selling price is recorded because there is a legally enforceable obligation from the distributor to pay the Company currently for product delivered, (ii) inventory is relieved for the carrying value of products shipped because legal title has passed to the distributor, and (iii) deferred revenue and deferred cost of inventory are recorded under the Deferred income on sales to distributors caption in the liability section of the Company's consolidated balance sheets. The Company evaluates the deferred cost of inventory component of this account for possible impairment by considering potential obsolescence of products that might be returned and by considering the potential of resale prices of these products being below the Company's cost. By reviewing deferred inventory costs in the manners discussed above, the Company ensures that any portion of deferred inventory costs that are not recoverable from future contractual revenue are charged to cost of sales as an expense. Deferred income on sales to distributors effectively represents the gross margin on sales to distributors, however, the amount of gross margin that is recognized in future periods may be less than the originally recorded deferred income as a result of negotiated price concessions. In recent years, such concessions have exceeded 30% of list price on average. For detail of this account balance, see Note 3 Supplemental Financial Statement Data to these consolidated financial statements.

Revenues from other distributors are recognized at the time of shipment and when title and risk of loss transfer to the distributor, in accordance with the terms specified in the arrangement, and when the four above mentioned revenue recognition criteria are met. These distributors may also be given business terms to return a portion of inventory, however they do not receive credits for changes in selling prices to end customers. At the time of shipment, product prices are fixed and determinable and the amount of future returns can be reasonably estimated and accrued.

Revenue from the sale and license of intellectual property is recognized when the above mentioned four revenue recognition criteria are met. Development revenue is recognized when services are performed and customer acceptance has been received and was not significant for any of the periods presented.

*Cash and Cash Equivalents* The Company considers all highly liquid investments with insignificant interest rate risk and original maturities of three months or less from the date of purchase to be cash equivalents. The carrying amounts of cash and cash equivalents approximate their fair values.

*Inventories* Inventories are stated at the lower of cost or market. Cost is computed using the average cost method on a currently adjusted standard basis (which approximates actual cost); market is based upon estimated net realizable value. The valuation of inventories at the lower of cost or market requires the use of estimates as to the amounts of

current inventories that will be sold. These estimates are dependent on the Company's assessment of current and expected orders from its customers, and orders generally are subject to cancellation with limited advance notice prior to shipment.

*Property, Plant and Equipment* Property, plant and equipment is stated at cost. Depreciation is based on estimated useful lives (principally ten years for furniture and fixtures; three to five years for machinery and

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

equipment and photomasks; three years for computer software; and the shorter of the remaining terms of the leases or the estimated economic useful lives of the improvements for land and leasehold improvements). Significant renewals and betterments are capitalized and replaced units are written off. Maintenance and repairs are charged to expense.

*Goodwill* Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. The Company performs a two-step process on an annual basis, or more frequently if necessary, to determine 1) whether the fair value of the relevant reporting unit exceeds carrying value and 2) to measure the amount of an impairment loss, if any. The Company completed this process in July 2008 and determined that there was no impairment to goodwill.

*Intangible Assets, net* Intangible assets, net, consist of backlog, and developed technology and are amortized on a straight-line basis over estimated useful lives of three months to five years.

*License Agreements* License agreements consist mainly of licenses of intellectual property that the Company uses in certain of its products. These licensed assets are amortized on a straight-line basis over the estimated production life cycle of each respective product, usually ranging from three to five years. The Company expects to record amortization of its license agreements of \$836,000 (2009), \$835,000 (2010), \$642,000 (2011), \$606,000 (2012) and \$428,000 (2013), and the weighted average remaining life was 30 months.

*Impairment of Long-Lived Assets* The Company continually monitors events or changes in circumstances that could indicate that the carrying amount of long-lived assets to be held and used, including intangible assets, may not be recoverable. The determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. When impairment is indicated for a long-lived asset, the amount of impairment loss is the excess of net book value over fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. As of October 3, 2008, the Company identified no circumstances that indicated a potential impairment of any of its long-lived assets.

*Foreign Currency Translation and Remeasurement* The Company's foreign operations are subject to exchange rate fluctuations and foreign currency transaction costs. The functional currency of the Company's principal foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign functional currencies are translated into U.S. dollars at the rates of exchange in effect at the balance sheet dates and income and expense items are translated at the average exchange rates prevailing during the period. The resulting foreign currency translation adjustments are accumulated as a component of other comprehensive income. For the remainder of the Company's foreign subsidiaries, the functional currency is the U.S. dollar. Inventories, property, plant and equipment, cost of goods sold and depreciation for those operations are remeasured from foreign currencies into U.S. dollars at historical exchange rates; other accounts are translated at current exchange rates. Gains and losses resulting from those remeasurements are included in earnings. Gains and losses resulting from foreign currency transactions are recognized currently in earnings.

*Research and Development* Research and development costs, other than software development costs, are expensed as incurred. Development costs for software to be sold or marketed are capitalized following attainment of technological feasibility. No development costs that qualify for capitalization were incurred during any of the periods presented.



*Product Warranties* The Company's products typically carry a warranty for periods of up to five years. The Company establishes reserves for estimated product warranty costs in the period the related revenue is recognized, based on historical experience and any known product warranty issues. Product warranty reserves are not significant in any of the periods presented.

*Stock-Based Compensation* Effective October 1, 2005, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) to account for stock-based compensation. SFAS 123R requires that the Company account for all stock-based compensation transactions using a fair-value method and recognize the

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

fair value of each award as an expense over the service period. The fair value of restricted stock awards is based upon the market price of the Company's common stock at the grant date. The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The use of the Black-Scholes model requires a number of estimates, including the expected option term, the expected volatility in the price of the Company's common stock, the risk-free rate of interest and the dividend yield on the Company's common stock. Judgment is required in estimating the number of share-based awards that we expect will ultimately vest upon the fulfillment of service conditions (such as time-based vesting) or the achievement of specific performance conditions. The financial statements include amounts that are based on the Company's best estimates and judgments.

*Other Income, net* Other income consists of interest income, foreign exchange gains and losses, franchise taxes and other non-operating gains and losses.

*Income Taxes* The provision for income taxes is determined in accordance with SFAS No. 109, Accounting For Income Taxes. Deferred tax assets and liabilities are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities, applying enacted statutory tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded when it is more likely than not that some or all of the deferred tax assets will not be realized.

On September 29, 2007, the Company adopted FIN 48, which is a change in accounting for income taxes. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. The Company will classify the liability for unrecognized tax benefits as current to the extent that the Company anticipates payment (or receipt) of cash within one year. The Company recognizes interest and penalties related to unrecognized tax benefits in the tax provision.

*Per Share Information* Basic income/(loss) per share is computed by dividing net income by the weighted average number of shares outstanding. In computing diluted earnings per share, the weighted average number of shares outstanding is adjusted to additionally reflect the effect of potentially dilutive securities such as stock options, warrants, convertible senior notes and unvested restricted stock units. The dilutive effect of stock options, warrants and unvested restricted stock units is computed using the treasury stock method, which assumes any proceeds that could be obtained upon the exercise of stock options, warrants and vesting of restricted stock units would be used to purchase common shares at the average market price for the period. The assumed proceeds include the purchase price the grantee pays, the hypothetical windfall tax benefit that the Company receives upon assumed exercise or vesting and the hypothetical average unrecognized compensation expense for the period. The Company calculates the assumed proceeds from excess tax benefits based on the as-if deferred tax assets calculated under the provision of SFAS 123(R).

For the year ended October 3, 2008, potentially dilutive securities consisted of stock options and restricted stock and resulted in 0.2 million potential common shares. Stock options, warrants and convertible senior notes to purchase approximately 13.5 million shares for the year ended October 3, 2008 were outstanding but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

Because the Company incurred a net loss in fiscal 2007 and fiscal 2006, the potential dilutive effect of the Company's outstanding stock options, stock warrants and convertible senior notes was not included in the computation of diluted loss per share because these securities were antidilutive.

*Reclassifications* Certain reclassifications have been made to 2007 financial statements to conform to the 2008 presentation.

*Concentrations* Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of cash and cash equivalents and trade accounts receivable. Cash and cash equivalents consist of

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demand deposits and money market funds maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with high credit quality financial institutions and therefore have minimal credit risk. The Company's trade accounts receivable primarily are derived from sales to manufacturers of network infrastructure equipment and electronic component distributors. Management believes that credit risks on trade accounts receivable are moderated by the diversity of its end customers and geographic sales areas. The Company performs ongoing credit evaluations of its customers' financial condition and requires collateral, such as letters of credit and bank guarantees, whenever deemed necessary.

The following individual customers accounted for 10% or more of net revenues:

	2008	2007	2006
Customer A	16%	15%	11%
Customer B	11%	16%	17%
Customer C	3%	7%	11%

The following individual customers accounted for 10% or more of total accounts receivable at fiscal year ends:

	2008	2007
Customer B	9%	24%
Customer C	1%	16%
Customer D	20%	0%
Customer E	11%	4%
Customer F	0%	13%

*Supplemental Cash Flow Information* Interest paid was \$1.8 million, \$1.7 million, and \$1.7 million for fiscal 2008, fiscal 2007, and fiscal 2006, respectively. Income taxes paid, net of refunds received were \$222,000, \$2.3 million, and (\$36,000) during fiscal 2008, fiscal 2007, and fiscal 2006, respectively. Non-cash investing activities in fiscal 2008 and fiscal 2007 consisted of the purchase of \$306,000 and \$979,000, respectively of property and equipment from suppliers on account. Assets acquired consist of amounts paid and received during fiscal 2008 on cash, accounts receivable, accounts payable and accrued liabilities created through the acquisition of certain assets of Ample Communications, Inc., which occurred in the fourth quarter of fiscal 2007.

*Comprehensive Income/(Loss)* Accumulated other comprehensive income/(loss) at October 3, 2008, September 28, 2007 and September 29, 2006 consists of foreign currency translation adjustments. Foreign currency translation adjustments are not presented net of any tax effect as the Company does not expect to incur any tax liability or realize any benefit related thereto.

*Recent Accounting Standards* In September 2006, the FASB issued Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement, which defines fair value, establishes a framework for measuring fair value and expands

disclosures regarding assets and liabilities measured at fair value. In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP 157-1) and FSP 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2010. The measurement and disclosure requirements related to financial assets and financial liabilities are effective for us in the first quarter of fiscal 2009. The adoption of SFAS 157 for financial assets and financial liabilities is not expected to have a material impact on our results of operations or financial position. The Company is currently assessing the impact that SFAS 157 will have on its results of operations and financial position when it is applied to nonfinancial assets and nonfinancial liabilities beginning in the first quarter of fiscal 2010.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In February 2007, the FASB issued Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The statement permits entities to choose to measure many financial instruments and certain other items at fair value that are currently not required to be measured at fair value. The Company will be required to adopt SFAS 159 in the first quarter of fiscal 2009 and does not expect that the adoption will have a material impact on its financial condition or results of operations.

In June 2007, the FASB ratified Emerging Issues Task Force consensus on EITF Issue No. 07-3, *Accounting for Non-refundable Advanced Payments for Goods or Services to be Used in Future Research and Development Activities*. EITF Issue No. 07-3 requires that these payments be deferred and capitalized and expensed as goods are delivered or as the related services are performed. The Company will be required to adopt EITF 07-3 in the first quarter of fiscal 2009 and does not expect that the adoption will have a material impact on its financial condition or results of operations.

In December 2007, the FASB issued Financial Accounting Standards (SFAS) No. 141R, *Business Combinations*, and SFAS No. 160, *Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an Amendment of ARB No. 51 (SFAS No. 160)*. These new standards will significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. These Statements are effective for fiscal years beginning after December 15, 2008. The Company will be required to adopt SFAS No. 141R and SFAS No. 160 in the first quarter of fiscal 2010. Accordingly, to the extent the Company engages in any business combination transactions, such transaction will be recorded and disclosed following existing accounting principles until October 2, 2009.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an Amendment of FASB Statement No. 133. This Statement requires enhanced disclosures about an entity's derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will be required to adopt SFAS 161 in the first quarter of fiscal 2010 and does not expect that the adoption will have a material impact on its financial condition or results of operations.

In May 2008, the FASB issued FASB Staff Position FSP APB 14-1, *Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. This FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We will be required to adopt this FSP in the first quarter of fiscal 2010. Early adoption is not permitted. The Company believes this change in methodology will negatively affect our earnings and earnings per share as interest expense will be required to reflect the market rate of interest for nonconvertible debt. The Company is currently evaluating the magnitude of this impact on its financial condition and results of operations.

**3. Supplemental Financial Statement Data**

***Inventories***

Inventories at fiscal year ends consist of the following (in thousands):

	<b>2008</b>	<b>2007</b>
Work-in-process	\$ 8,620	\$ 7,497
Finished goods	7,567	7,526
	\$ 16,187	\$ 15,023

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The Company assesses the recoverability of inventories through an ongoing review of inventory levels in relation to sales backlog and forecasts, product marketing plans and product life cycles. When the inventory on hand exceeds the foreseeable demand, the value of inventory that at the time of the review is not expected to be sold is written down. The amount of the write-down is the excess of historical cost over estimated realizable value (generally zero). Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory.

The assessment of the recoverability of inventories, and the amounts of any write-downs, are based on currently available information and assumptions about future demand (generally over twelve months) and market conditions. Demand for the Company's 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.

The Company may retain and make available for sale some or all of the inventories which have been written down. In the event that actual demand is higher than originally projected, the Company may be able to sell a portion of these inventories in the future. The Company generally scraps inventories which have been written down and are identified as obsolete.

The Company's gross margin included a benefit of \$1.6 million (2008), \$4.0 million (2007) and \$5.5 million (2006) from the sale of inventories that the Company had written down to a zero cost basis during fiscal 2001. As of October 3, 2008, the Company continued to hold inventories with an original cost of \$6.0 million which were previously written down to a zero cost basis.

***Deferred Income on Shipments to Distributors***

Deferred income on shipments to distributors is as follows (in thousands):

	<b>October 3, 2008</b>	<b>September 28, 2007</b>
Deferred revenue on shipments to distributors	\$ 5,387	\$ 4,953
Deferred cost of inventory on shipments to distributors	(576)	(808)
Reserves	58	81
Deferred income on sales to distributors	\$ 4,869	\$ 4,226

***Property, Plant and Equipment***

Property, plant and equipment at fiscal year ends consist of the following (in thousands):

**2008**                      **2007**



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Machinery and equipment	\$ 73,229	\$ 74,072
Leasehold improvements	3,702	3,541
	76,931	77,613
Accumulated depreciation and amortization	(64,331)	(64,466)
	\$ 12,600	\$ 13,147

Table of Contents**MINDSPEED TECHNOLOGIES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Intangible Assets and Goodwill***

In conjunction with the acquisition of certain assets of Ample Communications, Inc. on September 25, 2007, the Company acquired certain intangible assets (see Note 15). These intangible assets consist of backlog (approximately \$100,000), developed technology (approximately \$3,100,000) and goodwill (approximately \$2,429,000). The Company expects to record amortization of its intangible assets of \$620,000 in fiscal 2009 through fiscal 2012. The weighted average remaining life of the amortizable intangible assets is approximately 48 months.

**4. Income Taxes**

The components of the provision for income taxes are as follows (in thousands):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Current:			
United States	\$	\$	\$
Foreign	99	566	2,137
State and local	10	10	10
Total current	109	576	2,147
Deferred:			
United States			
Foreign	502	(465)	(298)
State and local			
Total deferred	502	(465)	(298)
	\$ 611	\$ 111	\$ 1,849

A reconciliation of income taxes computed at the U.S. federal statutory income tax rate to the provision for income taxes on continuing operations follows (in thousands):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
U.S. federal statutory tax at 35%	\$ 2,733	\$ (7,642)	\$ (7,933)
State taxes, net of federal effect	739	(1,481)	(3,612)
Foreign income taxes in excess of U.S.	420	(293)	(524)
Research and development credits		(2,592)	(3,443)
Valuation allowance	(33,837)	13,992	17,187
Reversal of research and development credits, federal and state	29,041		

Other	1,515	(1,873)	174
Provision for income taxes	\$ 611	\$ 111	\$ 1,849

Income (loss) before income taxes consists of the following components (in thousands):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
United States	\$ 7,328	\$ (22,926)	\$ (29,418)
Foreign	518	1,123	6,753
	\$ 7,846	\$ (21,803)	\$ (22,665)

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Deferred income tax assets and liabilities at fiscal year-ends consist of the tax effects of temporary differences related to the following (in thousands):

	<b>2008</b>	<b>2007</b>
Deferred tax assets:		
Inventories	\$ 12,118	\$ 14,083
Deferred revenue	1,999	1,831
Accrued compensation and benefits	1,292	1,256
Product returns and allowances	745	801
Net operating losses	232,890	233,909
Research and development and investment credits		36,021
Foreign deferred taxes	1,113	1,615
Property, plant and equipment		673
Other	5,244	6,547
Valuation allowance	(248,299)	(282,136)
<b>Total deferred tax assets</b>	<b>7,102</b>	<b>14,600</b>
Deferred tax liabilities:		
Intangible assets		
Property, plant and equipment	379	
Deferred state taxes	5,610	12,985
Other		
<b>Total deferred tax liabilities</b>	<b>5,989</b>	<b>12,985</b>
<b>Net deferred tax assets</b>	<b>\$ 1,113</b>	<b>\$ 1,615</b>

Based upon the Company's operating losses and expected future operating results, management determined that it is more likely than not that the U.S. federal and state deferred tax assets as of October 3, 2008 and September 28, 2007 will not be realized through the reduction of future income tax payments. Consequently, the Company has established a valuation allowance for its net U.S. federal and state deferred tax assets as of those dates. Foreign deferred tax assets consist mainly of research and development credits and are expected to be realized through a reduction of future tax payments, therefore no valuation allowance has been established for these deferred tax assets.

Through the Distribution date, Mindspeed's results of operations were included in Conexant's consolidated federal and state income tax returns. The provision for income taxes and the related deferred tax assets and liabilities for periods prior to the Distribution were calculated as if Mindspeed had filed separate tax returns as an independent company.

In connection with the Distribution, Mindspeed and Conexant entered into a tax allocation agreement which provides, among other things, for the allocation between Conexant and Mindspeed of federal, state, local and foreign tax

liabilities relating to Mindspeed. The tax allocation agreement also allocates the liability for any taxes that may arise in connection with the Distribution. The tax allocation agreement generally provides that Conexant will be responsible for any such taxes. However, Mindspeed will be responsible for any taxes imposed on Mindspeed, Conexant or Conexant stockholders if either the Distribution fails to qualify as a reorganization for U.S. federal income tax purposes or the Distribution of Mindspeed Technologies common stock is disqualified as a tax-free transaction to Conexant for U.S. federal income tax purposes and such failure or disqualification is attributable to post-Distribution transaction actions by Mindspeed, its subsidiaries or its stockholders.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of October 3, 2008, Mindspeed had U.S. federal net operating loss carryforwards of approximately \$630.9 million, which expire at various dates through 2029, and aggregate state net operating loss carryforwards of approximately \$139.9 million, which expire at various dates through 2029.

The deferred tax assets as of October 3, 2008 include a deferred tax asset of \$11 million representing net operating losses arising from the exercise of stock options by Mindspeed employees. To the extent the Company realizes any tax benefit for the net operating losses attributable to the stock option exercises, such amount would be credited directly to stockholders' equity.

To date, the Company has not performed a formal study of potential research and development credits. If, at any time in the future, the Company determines it appropriate to conduct a formal study of potential research and development credits, completion of a study may have an effect on the Company's estimate of this unrealized tax benefit.

The Company has not provided for U.S. taxes or foreign withholding taxes on approximately \$700,000 of undistributed earnings from its foreign subsidiaries because such earnings are to be reinvested indefinitely. If these earnings were distributed, foreign tax credits may become available under current law to reduce the resulting U.S. income tax liability.

On July 13, 2006, the FASB issued interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

The Company adopted the provisions of FIN 48 on September 29, 2007. As a result of the adoption of FIN 48 and recognition of the cumulative effect of adoption of a new accounting principle, the Company recorded a \$202,000 decrease in the liability for unrecognized income tax benefits, with an offsetting decrease in accumulated deficit. As of September 29, 2007 the Company had approximately \$28.9 million of total unrecognized tax benefits. Of this total, \$474,000 represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate. The remaining \$28.4 million of unrecognized tax benefits, if recognized, would have no impact on the effective tax rate and be recorded as an increase to the Company's deferred tax assets with a related increase in the valuation allowance. However, to the extent that any portion of such benefit is recognized at the time a valuation allowance no longer exists, such benefit would favorably affect the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in the tax provision. As of September 29, 2007, the Company had no liability for the payment of interest and penalties. The liability for the payment of interest and penalties did not change as of October 3, 2008.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	<b>2008</b>
Balance as of September 29, 2007	\$ 28,917
Increases in tax positions for prior years	7,589
Increases in tax positions for current year	
Balance at October 3, 2008	\$ 36,506

The Company does not anticipate that unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date.

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company is currently open to audit under the statute of limitations by the taxing authorities for the years ending September 30, 2004 to 2008 in our foreign jurisdictions.

**5. Revolving Credit Facility and Convertible Senior Notes**

***Revolving Credit Facility***

On September 30, 2008, the Company entered into a loan and security agreement (the Loan and Security Agreement) with Silicon Valley Bank (SVB). Under the Loan and Security Agreement, SVB has agreed to provide the Company with a three-year revolving credit line of up to \$15.0 million, subject to availability against certain eligible accounts receivable, for the purposes of (i) working capital; (ii) funding its general business requirements; and (iii) repaying or repurchasing its convertible senior Notes due in 2009. The indebtedness of the Company to SVB under the Loan and Security Agreement is guaranteed by three domestic subsidiaries of the Company and secured by substantially all of the domestic assets of the Company and such subsidiaries other than intellectual property.

Any indebtedness under the Loan and Security Agreement bears interest at a variable rate ranging from prime plus 0.25 percent to a maximum rate of prime plus 1.25 percent, as determined in accordance with the interest rate grid set forth in the Loan and Security Agreement. The Loan and Security Agreement contains affirmative and negative covenants which, among other things, require the Company to maintain a minimum tangible net worth and to deliver to SVB specified financial information, including annual, quarterly and monthly financial information, and limit the Company's ability to (or to permit any subsidiaries to), subject to certain exceptions and limitations: (i) merge with or acquire other companies; (ii) create liens on its property; (iii) incur debt obligations; (iv) enter into transactions with affiliates, except on an arm's length basis; (v) dispose of property; and (vi) issue dividends or make distributions.

As of October 3, 2008, the Company was in compliance with all required covenants. Proceeds from the credit facility will be used to maintain liquidity and fund working capital requirements, on an as needed basis. At October 3, 2008, the Company had no outstanding borrowings under the credit facility with SVB.

***3.75% Convertible Senior Notes due 2009***

In December 2004, the Company sold \$46.0 million aggregate principal amount of convertible senior notes due 2009 for net proceeds (after discounts and commissions) of approximately \$43.9 million. The notes are senior unsecured obligations of the Company, ranking equal in right of payment with all future unsecured indebtedness. The notes bear interest at a rate of 3.75%, payable semiannually in arrears each May 18 and November 18. The Company used approximately \$3.3 million of the proceeds to purchase U.S. government securities that were pledged to the trustee for the payment of the first four scheduled interest payments on the notes when due.

The notes are convertible, at the option of the holder, at any time prior to maturity into shares of the Company's common stock. Upon conversion, the Company may, at its option, elect to deliver cash in lieu of shares of our common stock or a combination of cash and shares of common stock. Effective May 13, 2005, the conversion price of the notes was adjusted to \$11.55 per share (\$2.31 per share on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock, which is equal to a conversion rate of approximately 86.58 shares (432.9004 shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock per \$1,000 principal amount of notes. Prior to this adjustment, the conversion price applicable to the notes was \$14.05 per share (\$2.81 per share on a pre-June 30,



2008 one-for-five reverse stock split basis) of common stock, which was equal to approximately 71.17 shares (355.8719 shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of common stock per \$1,000 principal amount of notes. The adjustment was made pursuant to the terms of the indenture governing the notes. The conversion price is subject to further adjustment under the terms of the indenture to reflect stock dividends, stock splits, issuances of rights to purchase shares of common stock and certain other events.

If the Company undergoes certain fundamental changes (as defined in the indenture), holders of notes may require the Company to repurchase some or all of their notes at 100% of the principal amount plus accrued and unpaid interest. If, upon notice of certain events constituting a fundamental change, holders of the notes elect to convert the

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

notes, the Company will be required to increase the number of shares issuable upon conversion by up to 11.95 shares (59.75 on a pre-June 30, 2008 one-for-five reverse stock split basis) per \$1,000 principal amount of notes. The number of additional shares, if any, will be determined by the table set forth in the indenture governing the notes. In the event of a non-stock change of control constituting a public acquirer change of control (as defined in the indenture), the Company may, in lieu of issuing additional shares or making an additional cash payment upon conversion as required by the indenture, elect to adjust the conversion price and the related conversion obligation such that the noteholders will be entitled to convert their notes into a number of shares of public acquirer common stock.

For financial accounting purposes, the Company's contingent obligation to issue additional shares or make additional cash payment upon conversion following a fundamental change is an embedded derivative. As of October 3, 2008, the estimated fair value of the Company's liability under the fundamental change adjustment was not significant.

In connection with the sale of the notes, the Company granted the purchasers certain registration rights. The Company's Form S-3 registration statement covering the resale of the notes and the sale of shares issuable upon conversion of the notes was declared effective by the SEC on April 6, 2005.

Upon completion of the sale of the notes, the \$50 million Credit Agreement with Conexant was terminated. The Company had made no borrowings under the credit facility, and no portion of the related warrant is, or will become, exercisable.

As of October 3, 2008, the stated value of the convertible senior notes due 2009 was \$31 million and the estimated fair value of these notes was approximately \$26 million.

***6.50% Convertible Senior Notes due 2013***

On July 30, 2008, the Company entered into separate exchange agreements with certain holders of our existing convertible senior notes due 2009, pursuant to which holders of an aggregate of \$15 million of the existing notes agreed to exchange their notes for \$15 million in aggregate principal amount of a new series of convertible senior notes due 2013 (the new notes). The exchanges closed on August 1, 2008. The Company paid at the closing an aggregate of approximately \$100,000 in accrued and unpaid interest on the existing notes that were exchanged for the new notes, as well as approximately \$900,000 in transaction fees.

The Company issued the new notes pursuant to an indenture, dated as of August 1, 2008, between it and Wells Fargo Bank, N.A., as trustee. Following the completion of the exchange, \$31 million in aggregate principal amount of the 3.75% Convertible Senior Notes remain outstanding.

The new notes are unsecured senior indebtedness and bear interest at a rate of 6.50% per annum. Interest is payable on February 1 and August 1 of each year, commencing on February 1, 2009. The new notes mature on August 1, 2013. At maturity, the Company will be required to repay the outstanding principal of the new notes.

The new notes are convertible at the option of the holders, at any time on or prior to maturity, into shares of the Company's common stock at a conversion rate initially equal to approximately \$4.74 per share of common stock, which is subject to adjustment in certain circumstances. Upon conversion of the new notes, we generally have the right to deliver to the holders thereof, at our option: (i) cash; (ii) shares of our common stock; or (iii) a combination

thereof. The initial conversion price of the new notes will be adjusted to reflect stock dividends, stock splits, issuances of rights to purchase shares of our common stock, and upon other events. If we undergo certain fundamental changes prior to maturity of the new notes, the holders thereof will have the right, at their option, to require us to repurchase for cash some or all of their new notes at a repurchase price equal to 100% of the principal amount of the new notes being repurchased, plus accrued and unpaid interest (including additional interest, if any) to, but not including, the repurchase date, or convert the new notes into shares of our common stock and, under certain circumstances, receive additional shares of our common stock in the amount provided in the indenture.

For financial accounting purposes, the Company's contingent obligation to issue additional shares or make additional cash payment upon conversion following a fundamental change is an embedded derivative. As of

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

October 3, 2008, the estimated fair value of the Company's liability under the fundamental change adjustment was not significant.

If there is an event of default under the new notes, the principal of and premium, if any, on all the new notes and the interest accrued thereon may be declared immediately due and payable, subject to certain conditions set forth in the indenture. An event of default under the indenture will occur if we: (i) are delinquent in making certain payments due under the new notes; (ii) fail to deliver shares of common stock or cash upon conversion of the new notes; (iii) fail to deliver certain required notices under the new notes; (iv) fail, following notice, to cure a breach of a covenant under the new notes or the indenture; (v) incur certain events of default with respect to other indebtedness; or (vi) is subject to certain bankruptcy proceedings or orders. If we fail to deliver certain SEC reports to the trustee in a timely manner as required by the indenture, (x) the interest rate applicable to the new notes during the delinquency will be increased by 0.25% or 0.50%, as applicable (depending on the duration of the delinquency), and (y) if the required reports are not delivered to the trustee within 180 days after their due date under the indenture, a holder of the new notes will generally have the right, subject to certain limitations, to require us to repurchase all or any portion of the new notes then held by such holder.

As of October 3, 2008, the estimated fair value of the convertible senior notes due 2013 was approximately \$15 million.

**6. Commitments**

In June 2007, the Company extended its Sublease with Conexant pursuant to which the Company leases its headquarters in Newport Beach, California. The Sublease, which had been amended and restated in March 2005, had an initial term through June 2008. The Sublease has been extended for an additional two year term (through June 2010) for a reduced amount of space. Rent payable under the Sublease for the next 12 months is approximately \$3.4 million. Rent payable is subject to annual increases of 3%, plus a prorated portion of operating expenses associated with the leased property. The Company estimates its minimum future obligation under the Sublease at approximately \$10.2 million over the remainder of the lease term, but actual costs under the Sublease will vary based upon Conexant's actual costs. In addition, each year the Company may elect to purchase certain services from Conexant based on a prorated portion of Conexant's actual costs.

The Company leases its other facilities and certain equipment under non-cancelable operating leases. The leases expire at various dates through 2014 and contain various provisions for rental adjustments including, in certain cases, adjustments based on increases in the Consumer Price Index. The leases generally contain renewal provisions for varying periods of time.

Amounts due under facility leases were approximately \$8.0 million (2008), \$8.8 million (2007), and \$7.7 million (2006) including \$6.5 million (2008), \$6.6 million (2007), and \$6.5 million (2006) paid to Conexant under the Sublease. As of October 3, 2008, the Company's minimum future obligations under operating leases (including the estimated minimum future obligation under the Sublease) are as follows (in thousands):

**Fiscal Year**

2009	\$ 7,577
2010	5,770
2011	944
2012	726
2013	753
Thereafter	373
Total minimum future lease payments	\$ 16,143

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. Contingencies**

Various lawsuits, claims and proceedings have been or may be instituted or asserted against Conexant or Mindspeed, 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 current and future litigation against Conexant or its subsidiaries to the extent such matters relate to Mindspeed.

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 the Company will be able to license a third party's intellectual property. 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.

**8. 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 generally 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 stockholders. 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. Some customer guarantees and indemnities, and 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 balance sheets.

**9. Capital Stock**

The Company's authorized capital consists of 100,000,000 shares of common stock, par value \$0.01 per share, and 25,000,000 shares of preferred stock, par value \$0.01 per share, of which 2,500,000 shares are designated as Series A junior participating preferred stock (Junior Preferred Stock).

The Company has a preferred share purchase rights plan to protect stockholders' rights in the event of a proposed takeover of the Company. Pursuant to the preferred share purchase right (a Right) attached to each share of common stock, the holder may, in certain takeover-related circumstances, become entitled to purchase from the Company 5/100th of a share of Junior Preferred Stock at a price of \$20, subject to adjustment. Also, in certain takeover-related circumstances, each Right (other than those held by an acquiring person) will generally be exercisable for shares of the Company's common stock or stock of the acquiring person having a then-current market value of twice the

exercise price. In certain events, each Right may be exchanged by the Company for one share of common stock or 5/100th of a share of Junior Preferred Stock. The Rights expire on June 26, 2013, unless earlier exchanged or redeemed at a redemption price of \$0.01 per Right, subject to adjustment.

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**MINDSPEED TECHNOLOGIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Warrants***

In the Distribution, Mindspeed issued to Conexant a warrant to purchase six million shares (30 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of Mindspeed common stock at a price of \$17.04 per share (\$3.408 per share on a pre-June 30, 2008 one-for-five reverse stock split basis), exercisable through June 27, 2013. The \$89 million fair value of the warrant (estimated by management at the time of the Distribution using the Black-Scholes option pricing model) was recorded as a return of capital to Conexant. As of October 3, 2008, the entire warrant remains outstanding.

The warrant held by Conexant contains antidilution provisions that provide for adjustment of the warrant's exercise price, and the number of shares issuable under the warrant, upon the occurrence of certain events. In the event that the Company issues, or is deemed to have issued, shares of its common stock, or securities convertible into its common stock, at prices below the current market price of its common stock (as defined in the warrant) at the time of the issuance of such securities, the warrant's exercise price will be reduced and the number of shares issuable under the warrant will be increased. The amount of such adjustment, if any, will be determined pursuant to a formula specified in the warrant and will depend on the number of shares issued, the offering price and the current market price of the common stock at the time of the issuance of such securities.

**10. Stock-Based Compensation**

Effective October 1, 2005, the Company adopted Financial Accounting Standards (SFAS) 123R, Share-Based Payment using the modified prospective application. The Company elected the transition method described in FASB Staff Position (FSP) FAS 123R-3 related to accounting for the tax effects of share-based payment awards to employees. SFAS 123R requires that the Company account for all stock-based compensation transactions using a fair-value method and recognize the fair value of each award as an expense over the service period. As required by SFAS 123R, our stock-based compensation expense for fiscal 2008, fiscal 2007 and fiscal 2006 includes the fair value of new awards, modified awards and any unvested awards outstanding at October 1, 2005. The fair value of restricted stock awards is based upon the market price of our common stock at the grant date. The Company estimates the fair value of stock option awards, as of the grant date, using the Black-Scholes option-pricing model. The fair value of each award is recognized on a straight-line basis over the vesting or service period.

Stock-based compensation awards generally vest over time and require continued service to the Company and, in some cases, require the achievement of specified performance conditions. The amount of compensation expense recognized is based upon the number of awards that are ultimately expected to vest. The Company estimates forfeiture rates of 10% to 12.5% depending on the characteristics of the award.

As a result of the Company's recent operating losses and the possibility of future operating results, no income tax benefits have been recognized for any U.S. federal and state operating losses including those related to stock-based compensation expense. The Company does not expect to recognize any income tax benefits relating to future operating losses until it determines that such tax benefits are more likely than not to be realized.

The fair value of stock options awarded was estimated at the date of grant using the Black-Scholes option-pricing model. The following table summarizes the weighted-average assumptions used and the resulting fair value of options granted:



	<b>2008</b>	<b>2007</b>	<b>2006</b>
Weighted-average fair value of options granted	\$ 1.84	\$ 5.80	\$ 7.65
Weighted-average assumptions:			
Expected volatility	64%	74%	77%
Dividend yield			
Expected option life	3.2 years	3.3 years	3.4 years
Risk-free interest rate	2.8%	4.7%	4.7%

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The expected option term was estimated based upon historical experience and management's expectation of exercise behavior. The expected volatility of the Company's stock price is based upon the historical daily changes in the price of the Company's common stock. The risk-free interest rate is based upon the current yield on U.S. Treasury securities having a term similar to the expected option term. Dividend yield is estimated at zero because the Company does not anticipate paying dividends in the foreseeable future.

Stock-based compensation expense related to employee stock options and restricted stock under SFAS 123R was allocated as follows (in thousands):

	<b>2008</b>	<b>2007</b>
Cost of goods sold	\$ 173	\$ 385
Research and development	2,267	2,587
Selling, general and administrative	3,066	4,260
Special charges		69
Total stock-based compensation expense	\$ 5,506	\$ 7,301

***Stock Compensation Plans***

The Company has two principal stock incentive plans: the 2003 Long-Term Incentives Plan and the Directors Stock Plan. The 2003 Long-Term Incentives Plan provides for the grant of stock options, restricted stock, restricted stock units and other stock-based awards to officers and employees of the Company. The Directors Stock Plan provides for the grant of stock options, restricted stock units and other stock-based awards to the Company's non-employee directors. As of October 3, 2008, an aggregate of 339,000 shares of the Company's common stock were available for issuance under these plans. On March 5, 2007 the stockholders of the Company approved plan amendments which, among other things, (1) increased the authorized number of shares reserved for issuance under the 2003 Long-Term Incentives Plan to 3.9 million shares (19.3 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis), (2) removed the "evergreen" provision from the Directors Stock Plan that automatically increased the number of shares available under the Plan each year and (3) fixed the total number of shares authorized for issuance under the Directors Stock Plan at 288,000 (1,440,000 on a pre-June 30, 2008 one-for-five reverse stock split basis).

The Company also has a 2003 Stock Option Plan, under which stock options were issued in connection with the Distribution. In the Distribution, each holder of a Conexant stock option (other than options held by persons in certain foreign locations) received an option to purchase a number of shares of Mindspeed common stock. The number of shares subject to, and the exercise prices of, the outstanding Conexant options and the Mindspeed options were adjusted so that the aggregate intrinsic value of the options was equal to the intrinsic value of the Conexant option immediately prior to the Distribution and the ratio of the exercise price per share to the market value per share of each option was the same immediately before and after the Distribution. As a result of such option adjustments, Mindspeed issued options to purchase an aggregate of approximately six million shares (29.9 million shares on a pre-June 30, 2008 one-for-five reverse stock split basis) of its common stock to holders of Conexant stock options (including Mindspeed employees) under the 2003 Stock Option Plan. There are no shares available for new stock option awards

under the 2003 Stock Option Plan. However, any shares subject to the unexercised portion of any terminated, forfeited or cancelled option are available for future option grants only in connection with an offer to exchange outstanding options for new options.

Prior to February 2007, the Company maintained employee stock purchase plans for its domestic and foreign employees. Under SFAS 123R, the plans were non-compensatory and the Company has recorded no compensation expense in connection therewith. The employee stock purchase plans were terminated by the Company's board of directors effective February 28, 2007. During the years ended September 30, 2007 and 2006, the Company issued 7,000 (35,000 on a pre-June 30, 2008 one-for-five reverse stock split basis) and 21,600 shares (108,000 shares on a

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pre-June 30, 2008 one-for-five reverse stock split basis) of its common stock under the employee stock purchase plan for net proceeds of \$81,000 and \$298,000, respectively.

From time to time, the Company may issue, and has previously issued stock based awards outside of these plans pursuant to stand-alone agreements and in accordance with NASDAQ Marketplace Rule 4350(i)(1)(A)(iv).

***Stock Option Awards***

Prior to fiscal 2006, stock-based compensation consisted principally of stock options. Eligible employees received grants of stock options at the time of hire; the Company also made broad-based stock option grants covering substantially all employees annually. Stock option awards have exercise prices not less than the market price of the common stock at the grant date and a contractual term of eight or ten years, and are subject to time-based vesting (generally over four years). The following table summarizes stock option activity under all plans (shares in thousands and adjusted to reflect our June 30, 2008 one-for-five reverse stock split):

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at September 30, 2005	5,216	\$ 11.50		
Exercisable at September 30, 2005	3,821	\$ 11.05		
Granted	205	13.55		
Exercised	(602)	8.80		\$ 4.4 million
Forfeited or expired	(380)	15.90		
Outstanding at September 29, 2006	4,439	\$ 11.60	4.3 years	\$ 1.9 million
Exercisable at September 29, 2006	3,734	\$ 11.30	3.9 years	\$ 1.4 million
Granted	491	10.85		
Exercised	(422)	8.05		\$ 1.2 million
Forfeited or expired	(526)	13.25		
Outstanding at September 28, 2007	3,982	\$ 11.65	4.0 years	\$ 1.4 million
Exercisable at September 28, 2007	3,308	\$ 11.55	3.3 years	\$ 1.3 million
Granted	495	4.20		

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Exercised	(18)		5.97		\$	33,000
Forfeited or expired	(931)		12.15			
Outstanding at October 3, 2008	3,528	\$	10.50	3.7 years	\$	
Exercisable at October 3, 2008	2,704	\$	11.59	2.6 years	\$	
Vested and expected to vest	3,433	\$	10.65	3.6 years	\$	

As of October 3, 2008, there was unrecognized compensation expense of \$2.0 million related to unvested stock options, which the Company expects to recognize over a weighted-average period of 1.4 years.

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The following table summarizes all options to purchase Mindspeed common stock outstanding at October 3, 2008 (shares in thousands and adjusted to reflect our June 30, 2008 one-for-five reverse stock split):

<b>Range of Exercise Prices</b>	<b>Number of Shares</b>	<b>Outstanding Average Remaining Contractual Life (Years)</b>	<b>Weighted- Average Exercise Price</b>	<b>Exercisable Number of Shares</b>	<b>Weighted- Average Exercise Price</b>
\$ 2.08 - \$ 4.85	640	2.0	\$ 4.01	172	\$ 4.63
5.02 - 9.90	971	0.9	8.60	912	8.64
10.00 - 19.90	1,803	2.6	12.69	1,506	12.90
20.05 - 29.96	76	0.2	22.37	76	22.37
30.27 - 49.45	38	2.8	40.10	38	40.10
2.08 - 49.45	3,528	1.8	10.50	2,704	11.59

***Restricted Stock Awards***

The Company's stock incentive plans also provide for awards of restricted shares of common stock and other stock-based incentive awards and from time to time the Company has used restricted stock awards for incentive or retention purposes. Restricted stock awards have time-based vesting and/or performance conditions and are generally subject to forfeiture if employment terminates prior to the end of the service period or if the prescribed performance criteria are not met. Restricted stock awards are valued at the grant date based upon the market price of the Company's common stock and the fair value of each award is charged to expense over the service period.

Restricted stock grants, adjusted for our one-for-five stock split which occurred on June 30, 2008, totaled 772,000 shares (2008), 556,000 shares (2007) and 833,000 shares (2006). Many of the Company's restricted stock awards are intended to provide performance emphasis and incentive compensation through vesting tied to each employee's performance against individual goals, as well as to improvements in the Company's operating performance. The actual amounts of expense will depend on the number of awards that ultimately vest upon the satisfaction of the related performance and service conditions.

The fair value of each award is charged to expense over the service period. The actual amounts of expense will depend on the number of awards that ultimately vest upon the satisfaction of the related performance and service conditions. The following table summarizes restricted stock award activity (shares in thousands and adjusted to reflect our June 30, 2008 one-for-five reverse stock split):

**Weighted-**

	<b>Number of Shares</b>	<b>Average Grant Date Fair Value</b>
Nonvested shares at September 29, 2006	735	\$ 12.70
Granted	556	9.55
Vested	(531)	11.55
Forfeited	(122)	12.20
Nonvested shares at September 28, 2007	638	\$ 10.85
Granted	772	4.49
Vested	(594)	7.64
Forfeited	(134)	8.87
Nonvested shares at October 3, 2008	682	\$ 6.69

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The total fair value of shares vested during the year ended October 3, 2008 was \$3.4 million. As of October 3, 2008, there was unrecognized compensation expense of \$2.0 million related to unvested restricted stock awards, which the Company expects to recognize over a weighted-average period of 0.9 years.

**11. Employee Benefit Plans**

The Company sponsors a 401(k) retirement savings plan for its eligible employees. The Company matches a portion of employee contributions and can fund the matching contribution in shares of its common stock or in cash. In fiscal 2008, the Company issued 70,000 shares (adjusted to reflect our June 30, 2008 one-for-five reverse stock split) and contributed \$914,000 in cash to fund the matching contributions. In fiscal 2007 and fiscal 2006, the Company issued 122,000 shares, and 66,000 shares, respectively, of its common stock (adjusted to reflect our June 30, 2008 one-for-five reverse stock split) to fund the matching contributions. The Company recognized expenses under the retirement savings plans, of \$1.4 million (2008), \$1.2 million (2007), and \$0.8 million (2006).

**12. Special Charges**

Special charges consist of the following (in thousands):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Restructuring charges	\$ 211	\$ 4,724	\$ 2,550

*Mindspeed Restructuring Plans* In fiscal 2006 and 2007, 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.

Activity and liability balances related to the Mindspeed restructuring plans through October 3, 2008 are as follows (in thousands):

	<b>Workforce Reductions</b>	<b>Facility and Other</b>	<b>Total</b>
Restructuring balance, September 29, 2006	\$ 953	\$ 714	\$ 1,667
Charged to costs and expenses	2,191	2,533	4,724
Non cash charges	(61)		(61)
Cash payments	(2,851)	(1,995)	(4,846)
Restructuring balance, September 28, 2007	232	1,252	1,484
Charged to costs and expenses	(40)	251	211
Non cash charges		(71)	(71)
Cash payments	(186)	(1,430)	(1,616)



Restructuring balance, October 3, 2008	\$	6	\$	2	\$	8
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**13. Related Party Transactions**

The Company leases its headquarters and principal design center in Newport Beach, California from Conexant. For the years ended October 3, 2008, September 28, 2007, and September 29, 2006, rent and operating expenses paid to Conexant were \$6.5 million, \$6.6 million, and \$6.5 million, respectively.

The Company made no sales to Conexant during the years ended October 3, 2008, September 28, 2007 and September 29, 2006. At October 3, 2008, the Company had a liability to Conexant of \$185,000 associated with the rental of our facility. The Company had no liability to Conexant at September 28, 2007 and September 29, 2006.

**Table of Contents****MINDSPEED TECHNOLOGIES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****14. Segment and Other Information**

The Company operates a single business segment which designs, develops and sells semiconductor networking solutions for communications applications in enterprise, access, metropolitan and wide-area networks. Revenues by product line are as follows (in thousands):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Multiservice access DSP products	\$ 55,752	\$ 36,340	\$ 37,404
High-performance analog products	41,900	37,482	42,742
WAN communications products	63,047	53,983	55,773
	\$ 160,699	\$ 127,805	\$ 135,919

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

	<b>2008</b>	<b>2007</b>	<b>2006</b>
United States	\$ 51,775	\$ 39,036	\$ 41,151
Other Americas	6,317	7,197	4,510
Total Americas	58,092	46,233	45,661
Malaysia	7,097	8,841	16,999
Taiwan	5,803	6,937	7,088
China	49,574	35,343	35,501
Japan	8,040	7,411	7,376
Other Asia-Pacific	11,999	8,576	6,754
Total Asia-Pacific	82,513	67,108	73,718
Europe, Middle East and Africa	20,094	14,464	16,540
	\$ 160,699	\$ 127,805	\$ 135,919

No