CONEXANT SYSTEMS INC
Form 10-Q
May 08, 2001

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001*

OR

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

COMMISSION FILE NUMBER: 000-24923

CONEXANT SYSTEMS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

4311 JAMBOREE ROAD
NEWPORT BEACH, CALIFORNIA 92660-3095
(Address of principal executive offices) (Zip code)

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

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

Registrant's number of shares of common stock outstanding as of April 27, 2001 was 247,085,255.

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* For presentation purposes of this Form 10-Q, references made to the March 31, 2001 period relate to the actual fiscal second quarter ended March 30, 2001.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONEXANT SYSTEMS, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS
(unaudited, in thousands, except per share amounts)

	March 31, 2001	September 30 2000
ASSETS		

Current assets:		
Cash and cash equivalents	$ 124,144	$ 831,100
Short-term investments	314,365	17,397
Receivables, net of allowances of $19,743 and $6,949 at March 31, 2001 and September 30, 2000, respectively	249,135	422,650
Inventories	253,657	341,002
Deferred income taxes	110,306	95,260
Other current assets	73,778	66,733
Total current assets	1,125,385	1,774,142
Marketable securities	--	95,876
Property, plant and equipment, net	852,087	828,511
Goodwill and intangible assets, net	1,355,089	1,507,326
Other assets	283,990	209,056
Deferred income taxes	151,064	1,286
Total assets	$ 3,767,615	$ 4,416,197

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 123,204	$ 233,865
Deferred revenue	29,357	37,586
Accrued compensation and benefits	56,852	88,399
Other current liabilities	98,060	95,158
Total current liabilities	307,473	455,008
Convertible subordinated notes	709,849	999,997
Other long-term liabilities	55,446	54,433
Total liabilities	1,072,768	1,509,438
Commitments and contingencies	--	--
Shareholders' equity:		
Preferred and junior preferred stock	--	--
Common stock ($1.00 par value, 1,000,000 shares authorized; 245,024 and 231,164 shares issued at March 31, 2001 and September 30, 2000, respectively)	245,024	231,164
Additional paid-in capital	3,050,643	2,775,115
Accumulated deficit	(582,462)	(120,875)
Accumulated other comprehensive income (loss)	(1,181)	47,295
Treasury stock, at cost (39 and 30 shares at March 31, 2001 and September 30, 2000, respectively)	(1,791)	(1,619)
Unearned compensation	(15,386)	(24,321)
Total shareholders' equity	2,694,847	2,906,759
Total liabilities and shareholders' equity	$ 3,767,615	$ 4,416,197

See accompanying notes to consolidated condensed financial statements.

CONEXANT SYSTEMS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share amounts)

	Three Months Ended March 31,		Six Months March 3
	2001	2000	2001
Net revenues	$ 251,003	$ 501,728	$ 661,364
Cost of goods sold	334,168	269,459	630,771
Gross margin	(83,165)	232,269	30,593
Operating expenses:			
Research and development	128,879	100,095	247,417
Selling, general and administrative	89,741	66,024	170,117
Amortization of intangible assets	84,040	25,337	166,344
Restructuring charge	7,578	--	7,578
Separation costs	4,270	--	12,197
Purchased in-process research and development	--	145,900	--
Total operating expenses	314,508	337,356	603,653
Operating loss	(397,673)	(105,087)	(573,060)
Debt conversion costs	--	--	(42,584)
Other income (expense), net	(1,021)	932	(5,377)
Loss before income taxes	(398,694)	(104,155)	(621,021)
Provision (benefit) for income taxes	(136,683)	28,187	(152,150)
Loss before extraordinary item	(262,011)	(132,342)	(468,871)
Extraordinary gain on extinguishment of debt, net of income taxes of $4,426	--	--	7,284
Net loss	$(262,011)	$(132,342)	$(461,587)
Loss per share, basic and diluted:			
Loss before extraordinary item	$ (1.08)	$ (0.64)	$ (1.96)
Extraordinary item	--	--	0.04
Net loss	$ (1.08)	$ (0.64)	$ (1.92)
Number of shares used in per share computation	243,515	205,207	239,813

See accompanying notes to consolidated condensed financial statements.

CONEXANT SYSTEMS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Six Months Ended March 31, 2001	2000
Cash flows from operating activities:		
Net loss	$(461,587)	$ (80,511)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	98,250	92,413
Amortization of intangible assets	166,344	27,742
Purchased in-process research and development	--	145,900
Provision for losses on accounts receivable	12,913	1,197
Provision for inventory write-down	206,050	(471)
Deferred income taxes	(149,482)	(253)
Stock compensation	6,791	914
Debt conversion costs	42,584	--
Extraordinary gain--extinguishment of debt	(11,710)	--
Other non-cash charges	7,951	2,377
Changes in assets and liabilities:		
Receivables	160,602	(54,639)
Inventories	(118,705)	(35,384)
Accounts payable	(103,876)	(65,038)
Accrued expenses and other current liabilities	(15,937)	68,270
Other	(18,685)	1,773
Net cash provided by (used in) operating activities	(178,497)	104,290
Cash flows from investing activities:		
Net purchases of marketable securities	(253,658)	--
Capital expenditures	(118,833)	(160,874)
Investments in and advances to businesses	(89,090)	(112,196)
Acquisitions of businesses, net of cash acquired	(12,512)	(6,771)
Net cash used in investing activities	(474,093)	(279,841)
Cash flows from financing activities:		
Issuance of 4% convertible subordinated notes	--	631,300
Proceeds from exercise of stock options	10,618	76,627
Payment of debt conversion costs	(42,584)	--
Repurchase of convertible subordinated notes	(22,400)	--
Net cash provided by (used in) financing activities	(54,366)	707,927
Net increase (decrease) in cash and cash equivalents	(706,956)	532,376
Cash and cash equivalents at beginning of period	831,100	398,516
Cash and cash equivalents at end of period	$ 124,144	$ 930,892

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See accompanying notes to consolidated condensed financial statements.

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Conexant Systems, Inc. ("Conexant" or the "Company") is a leader in semiconductor system solutions for communications applications. Conexant leverages its expertise in mixed-signal processing to deliver integrated systems and semiconductor products which facilitate communications worldwide through wireline voice and data communications networks, cordless and cellular wireless telephony systems, personal imaging devices and equipment, and emerging cable and wireless broadband communications networks. The Company operates in two business segments: the Personal Networking business and Mindspeed Technologies(TM), the Company's Internet infrastructure business.

On March 26, 2001, the Company announced that its Board of Directors had approved in principle a revised plan for the separation of Mindspeed Technologies and the Personal Networking business. The separation will be accomplished by the spin-off of the Personal Networking business to Conexant shareholders as a new company which will retain the Conexant name. The separation is subject to the approval of the Company's shareholders and receipt of a ruling from the Internal Revenue Service that the spin-off will qualify as a tax-free distribution. There can be no assurance that the shareholder approval or the IRS ruling will be obtained, or that the separation will be successfully completed.

In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments, consisting of adjustments of a normal recurring nature, as well as the fiscal 2001 restructuring charge, separation costs, debt conversion costs, and extraordinary gain on extinguishment of debt and the fiscal 2000 write-off of purchased in-process research and development, necessary to present fairly the Company's financial position, results of operations, and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2000.

Fiscal Periods

For presentation purposes, references made to the periods ended March 31, 2001 relate to the actual fiscal 2001 second quarter and six months ended March 30, 2001.

Reclassifications

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

Recent Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value of derivatives either offset the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or are recognized in other comprehensive income until the hedged item is recognized in earnings. Generally, the change in a derivative's fair value related to the ineffective portion of a hedge, if any, is immediately recognized in earnings. The Company adopted SFAS 133 as of October 1, 2000, with no significant effect on the Company's financial position or results of operations.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements". SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition issues in financial statements. The Company will be required to adopt SAB 101 no later than the fourth quarter of fiscal 2001. Management believes that the adoption of SAB 101 will not have a significant effect on the Company's financial position or results of operations.

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)
(unaudited)

2. INVENTORIES

Inventories consisted of the following (in thousands):

	March 31, 2001	September 30, 2000
Raw materials	$ 28,089	$ 38,866
Work-in-process	132,232	209,871
Finished goods	93,336	92,265
	$253,657	$341,002

Cost of goods sold for the second quarter and first six months of fiscal 2001 includes provisions for excess and obsolete inventories of $148.6 million and $206.1 million, respectively.

3. MARKETABLE SECURITIES

Marketable securities include commercial paper, corporate bonds, government securities and equity securities. The Company enters into certain equity investments for the promotion of business and strategic objectives. The

marketable portion of these strategic investments is classified as marketable securities; non-marketable equity and other investments are included in other assets. All of the Company's marketable securities are classified as available-for-sale and are recorded on the consolidated condensed balance sheets at fair value, based upon quoted market prices. As of March 31, 2001, unrealized gains of $15.3 million (net of related income taxes of $9.3 million) on these securities are included in accumulated other comprehensive income. Available-for-sale marketable securities having a fair value of $314.4 million are classified as short-term investments in the consolidated balance sheet at March 31, 2001 as the Company intends to sell these securities as necessary to meet its liquidity requirements.

Available-for-sale marketable securities consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of March 31, 2001:				
U.S. government agencies	$ 39,915	$ 243	$ (5)	$ 40,153
Foreign governments	6,066	135	--	6,201
Corporate debt securities	228,433	2,928	(33)	231,328
Equity securities	15,374	21,309	--	36,683
	$289,788	$ 24,615	$ (38)	$314,365
As of September 30, 2000:				
U.S. government agencies	$ 14,795	$ 1	$ (60)	$ 14,736
Corporate debt securities	5,961	2	(7)	5,956
Equity securities	15,374	77,207	--	92,581
	$ 36,130	$ 77,210	$ (67)	$113,273

The amortized cost and estimated fair value of debt securities at March 31, 2001, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$ 81,279	$ 81,982
Due after one year through five years.........	178,857	181,200
Due after five years through ten years........	8,507	8,655
Due after ten years	5,771	5,845
	$274,414	$277,682

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)
(unaudited)

4. CONVERTIBLE SUBORDINATED NOTES

During the first six months of fiscal 2001, approximately $255.1 million principal amount of the Company's 4-1/4% Convertible Subordinated Notes due 2006 were converted into approximately 11.0 million shares of common stock at a cost to the Company of $42.6 million. In addition, the Company purchased $35.0 million principal amount of its 4% Convertible Subordinated Notes due 2007 at prevailing market prices, resulting in an extraordinary gain of $7.3 million (net of income taxes of $4.4 million).

5. CONTINGENT LIABILITIES

Claims have been asserted against the Company for utilizing the intellectual property rights of others in certain of the Company's products. The resolution of these matters may entail the negotiation of a license agreement, a settlement, or the resolution of such claims through arbitration or litigation. In connection with the Company's spin-off from Rockwell International Corporation ("Rockwell"), the Company assumed responsibility for all contingent liabilities and then current and future litigation (including environmental and intellectual property proceedings) against Rockwell or its subsidiaries in respect of the operations of the semiconductor systems business of Rockwell.

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

The Company has been designated as a potentially responsible party ("PRP") at one Superfund site located at a former silicon wafer manufacturing facility and steel fabrication plant in Parker Ford, Pennsylvania formerly occupied by the Company. In addition, the Company is engaged in remediations of groundwater contamination at its Newport Beach and Newbury Park, California facilities. Management currently estimates the aggregate remaining costs for these remediations to be approximately $4.4 million, which has been accrued.

6. COMPREHENSIVE LOSS

Comprehensive loss for the three months and six months ended March 31, 2001 and 2000 is as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2001	2000	2001	20

Net loss	$(262,011)	$(132,342)	$(461,587)	$ (80
Other comprehensive income (loss):				
Foreign currency translation adjustments	(8,097)	(1,920)	(16,369)	
Change in unrealized gains on available-for-sale securities	(1,998)	84,545	(52,566)	128
Change in unrealized gains on foreign currency forward contracts ...	220	--	291	
Effect of income taxes	756	(32,286)	20,168	(49
Other comprehensive income (loss)	(9,119)	50,339	(48,476)	79
Comprehensive loss	$(271,130)	$ (82,003)	$(510,063)	$

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)
(unaudited)

The components of accumulated other comprehensive income (loss) are as follows (in thousands):

	March 31, 2001	September 30, 2000
Unrealized gains on marketable securities, net of tax	$ 15,287	$ 47,685
Unrealized gains on foreign currency forward contracts	291	--
Foreign currency translation adjustments	(16,759)	(390)
Accumulated other comprehensive income (loss)	$ (1,181)	$ 47,295

7. LOSS PER SHARE

Basic loss per share is based on the weighted-average number of shares of common stock outstanding during the period. Diluted loss per share does not include the effect of stock options or other common stock equivalents or assume conversion of the Company's convertible subordinated notes, as their effect would be antidilutive for the periods presented. The weighted-average numbers of shares listed below were antidilutive and were excluded from the computation of diluted loss per share (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2001	2000	2001	2000
Stock options (under the treasury stock method)	6,927	18,719	9,679	17,994
4-1/4% Convertible Subordinated Notes due 2006	4,106	15,153	7,165	15,153

4% Convertible Subordinated Notes due 2007	5,694	3,678	5,800	1,839
Restricted stock and other	3,480	565	3,405	440

8. RESTRUCTURING CHARGE

During the second quarter of fiscal 2001, the Company announced a number of cost reduction initiatives to align its cost structure with the current business environment. The cost reduction initiatives include workforce reductions, temporary shutdowns of the Company's manufacturing facilities, significant reductions in capital spending, the consolidation of certain facilities, and salary reductions of 10% for the senior management team until the Company returns to profitability. When complete, the Company's worldwide workforce will be reduced by approximately 1,500 full-time employees and an additional 100 contractors, for a total workforce reduction of almost 20 percent.

As part of its cost reduction initiatives, during the second quarter of fiscal 2001 the Company implemented a 700-employee workforce reduction through involuntary severance programs and a consolidation of certain facilities. As a result of these actions, during the quarter ended March 31, 2001 the Company recorded a restructuring charge of $7.6 million. The charge was based upon estimates of the cost of severance benefits for affected employees and lease cancellation and related costs. The actions reduced the Company's workforce in both the Personal Networking and Mindspeed Technologies segments, including approximately 500 employees in the Company's manufacturing operations. Activity and liability balances related to the restructuring actions through March 31, 2001 are as follows (in thousands):

	Workforce reductions	Facility closing and other	Total
Charged to costs and expenses..........	$ 6,778	$800	$ 7,578
Cash payments..........................	(1,354)	--	(1,354)
Restructuring balance, March 31, 2001...	$ 5,424	$800	$ 6,224

All of the amounts accrued for these actions are expected to be paid within one year. Cash payments to complete the restructuring actions will be funded from available cash reserves and funds from operations, and are not expected to significantly impact the Company's liquidity.

CONEXANT SYSTEMS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)
(unaudited)

9. SUPPLEMENTAL CASH FLOW DISCLOSURES

Cash paid for interest, net of amounts capitalized, was $20.7 million and $5.7 million for the six months ended March 31, 2001 and 2000, respectively. Cash paid for income taxes for the six months ended March 31, 2001 and 2000 was $2.5 million and $15.8 million, respectively.

Significant noncash transactions during the six months ended March 31, 2001 and 2000 include income tax benefits of approximately $6.7 million and $160.8 million, respectively, resulting from employee stock transactions which were credited to additional paid-in capital.

10. SEGMENT INFORMATION

The Company operates in two reportable segments: the Personal Networking business and Mindspeed Technologies, the Company's Internet infrastructure business. The Company evaluates segment performance based on segment operating income (loss) excluding amortization of intangible assets and special charges. Special charges excluded from segment operating income (loss) for the three months and six months ended March 31, 2001 include the restructuring charge, separation costs incurred in connection with the proposed separation of the Mindspeed Technologies and Personal Networking businesses and stock compensation costs, representing the amortization of the value of unvested in-the-money stock options assumed by Conexant in connection with certain fiscal 2000 business acquisitions. The table below presents information about reported segments for the three months and six months ended March 31 (in thousands):

	Three months ended March 31,		Six months e March 31,	
	2001	2000	2001	
Net revenues:				
Personal Networking	$ 169,718	$ 376,504	$ 414,174	$
Mindspeed Technologies	81,285	125,224	247,190	
Segment totals	$ 251,003	$ 501,728	$ 661,364	$
Operating income (loss):				
Personal Networking	$(213,090)	$ 45,747	$(319,442)	$
Mindspeed Technologies	(86,476)	20,403	(62,793)	
Segment totals	(299,566)	66,150	(382,235)	
Amortization of intangible assets	84,040	25,337	166,344	
Purchased in-process research and development	--	145,900	--	
Restructuring charge	7,578	--	7,578	
Separation costs	4,270	--	12,197	
Stock compensation	2,219	--	4,706	
Operating loss	$(397,673)	$(105,087)	$(573,060)	$

11. SUBSEQUENT EVENT

As a result of its recent operating losses, the Company was not in compliance with certain covenants under its $475 million credit facility which required it to meet certain financial ratios tied to its consolidated EBITDA. Following a period of negotiations between the Company and the lenders under the credit facility, the parties terminated the credit facility effective as of May 8, 2001. The Company has had no borrowings outstanding under the credit facility since June 1999.

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

This information should be read in conjunction with the unaudited consolidated condensed financial statements and the notes thereto included in this Quarterly Report, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K for the year ended September 30, 2000.

OVERVIEW

Conexant is a leader in semiconductor system solutions for communications applications. Conexant leverages its expertise in mixed-signal processing to deliver integrated systems and semiconductor products which facilitate communications worldwide through wireline voice and data communications networks, cordless and cellular wireless telephony systems, personal imaging devices and equipment, and emerging cable and wireless broadband communications networks. The Company operates in two business segments: the Personal Networking business and Mindspeed Technologies(TM), the Company's Internet infrastructure business.

The Personal Networking business designs, develops and sells semiconductor products and system solutions in four general communications applications markets--Personal Computing, Personal Imaging, Digital Infotainment and Wireless Communications. Personal Computing products include telephony-based communications solutions for personal computing terminals and other communication devices such as gaming consoles, web browsers and handheld devices. Personal Imaging products consist of semiconductor and software products that enable image capture, processing and output for fax machines, printers and digital still and video cameras. Digital Infotainment products include semiconductor solutions that perform communication and media processing functions within a variety of information and entertainment platforms. Wireless Communications products are comprised of components, subsystems and system-level semiconductor solutions for wireless voice and data communication applications, including digital cellular handsets and base stations, cordless telephones and global positioning system ("GPS") receivers.

Mindspeed Technologies designs, develops and sells semiconductor products and system solutions for key communications infrastructure equipment markets including broadband access, multi-service access and wide area network ("WAN") transport. Mindspeed Technologies' broad product portfolio allows it to provide network infrastructure original equipment manufacturers ("OEMs") with system-level semiconductor solutions including multi-service access and high-speed digital subscriber line ("DSL") products used in a variety of network access platforms such as remote access concentrators, voice gateways, digital loop carriers, DSL access multiplexers and integrated access devices. Mindspeed Technologies also provides network infrastructure OEMs with an extensive family of communication solutions that support the aggregation, transmission and switching of data, video and voice from the edge of the network to the optical backbone, including T/E carrier, asynchronous transfer mode ("ATM") and synchronous optical networking ("SONET")/synchronous digital hierarchy ("SDH") products and network processors. These products are used in a variety of network equipment including high-speed routers, ATM switches, optical switches, add-drop multiplexers and digital cross-connect systems.

The Company markets and sells its semiconductor products and system solutions directly to leading OEMs of communication electronics products and third-party electronic manufacturing service providers, and indirectly through electronic components distributors. Although no customer accounted for more than 10% of net revenues for the first six months of fiscal 2001, the Company's top 20 customers accounted for 60% of net revenues for the period. Revenues derived from customers located in the Americas, Europe, Japan, and the Asia-Pacific region were 37%, 14%, 6% and 43%, respectively, of the Company's net revenues for the first six months of fiscal 2001.

RESULTS OF OPERATIONS

RECENT DEVELOPMENTS

During the first six months of fiscal 2001, the Company--like many of its customers and competitors--has been adversely impacted by a broad slow-down affecting the technology sector, including most of the communications electronics end-markets which the Company's products address. Personal Networking net revenues for the fiscal

2001 periods reflect continued deterioration in the digital cellular handset market resulting from lower subsidies of new digital cellular handsets by service providers and a slower transition to next-generation phones. Sales of broadband solutions were affected by slower than anticipated deployment of broadband services by system providers. Finally, weak consumer demand for PCs and related peripheral devices, fax machines, and satellite set-top boxes led to lower sales of the Company's products for these applications. Net revenues in the Mindspeed Technologies business were affected by slowing investment in communications network capacity expansion by Internet service providers ("ISPs"), competitive local exchange carriers ("CLECs") and incumbent local exchange and inter-exchange carriers. In most cases, the effect of weakened end-customer demand was compounded by higher than normal levels of equipment and component inventories among the Company's OEM, subcontractor and distributor customers. The Company believes that these and other factors will continue to adversely affect its revenues in the near term.

The overall slow-down in the communications electronics markets has also impacted the Company's gross margins and operating income. The Company's cost of goods sold for the fiscal 2001 periods has been adversely affected by the underutilization of its manufacturing capacity. Cost of goods sold for the fiscal 2001 periods also reflects $206.1 million of inventory reserves across the Company's product portfolio resulting from the sharply reduced end-customer demand for digital cellular handsets, set-top boxes, PC peripherals and Internet infrastructure equipment. In addition, during the first six months of fiscal 2001, the Company recorded $12.9 million of additional provisions for uncollectible accounts receivable from certain slow-paying customers. The Company believes the underutilization of its manufacturing capacity, changes in its revenue mix, and other factors will continue to adversely affect its gross margins and operating income in the near term.

Expense Reduction and Restructuring Initiatives

In March 2001, the Company announced a number of expense reduction initiatives and a comprehensive business reassessment focused on leveraging its core capabilities and aligning resources with its highest-growth, highest-margin market opportunities. The expense reduction initiatives include workforce reductions, temporary shutdowns of the Company's manufacturing facilities,

significant reductions in capital spending, the consolidation of certain facilities, and salary reductions of 10% for the senior management team until the Company returns to profitability.

The workforce reduction, which began in the second quarter of fiscal 2001, is expected to be completed by September 2001. When complete, the Company's worldwide workforce will be reduced by approximately 1,500 full-time employees and an additional 100 contractors, for a total workforce reduction of almost 20 percent. During the second quarter of fiscal 2001, the Company's workforce was reduced by nearly 700 employees. In April 2001, the Company idled its wafer fabrication facilities in Newport Beach and Newbury Park, California and its assembly and test facilities in Mexicali, Mexico for a two-week period. The three plants may be idled for a similar period during the Company's fourth fiscal quarter.

The Company is also conducting a comprehensive reassessment of its operations to focus investment and resources in the areas that best support the Company's strategic growth drivers--the Internet infrastructure, mobile communications and broadband access markets. As a result of this process, the Company is currently exploring strategic alternatives for its digital imaging business, which includes complementary metal-oxide semiconductor ("CMOS") image sensors and digital camera processors, and intends to enter into discussions with potential investors and buyers. The Company also intends to exit its board-level sub-assembly business and is currently examining the best alternative for removing its El Paso, Texas module assembly plant from its portfolio. Both of these actions are targeted for completion by September 30, 2001. However, there can be no assurance the Company will be successful in these efforts.

In connection with its expense reduction initiatives, the Company recorded a restructuring charge of $7.6 million in the second quarter of fiscal 2001 related to the workforce reduction and the consolidation of certain facilities. The Company's continuing business reassessment and expense reduction initiatives may require further charges for exit costs associated with its digital imaging business and its board-level sub-assembly business, or other actions.

Separation of Personal Networking and Mindspeed Technologies Businesses

On March 26, 2001, the Company announced that its Board of Directors had approved in principle a revised plan for the separation of Mindspeed Technologies and the Personal Networking business. The separation will be accomplished by the spin-off of the Personal Networking business to Conexant shareholders as a new company which will retain the Conexant name. The separation is subject to the approval of the Company's shareholders and receipt of a ruling from the Internal Revenue Service that the spin-off will qualify as a tax-free distribution. There can be no assurance that the shareholder approval or the IRS ruling will be obtained, or that the separation will be successfully completed.

NET REVENUES

The following table summarizes the Company's net revenues by business segment:

	Three months ended March 31,			Six months ended March 31,		
	2001	Change	2000	2001	Change	2000

(in thousands)

Net revenues:						
Personal Networking...........	$169,718	(55)%	$376,504	$414,174	(46)%	$ 767,
Mindspeed Technologies........	81,285	(35)%	125,224	247,190	1%	243,
	$251,003	(50)%	$501,728	$661,364	(35)%	$1,011,
As a percentage of Conexant's total net revenues:						
Personal Networking...........	68%		75%	63%		
Mindspeed Technologies........	32%		25%	37%		

Personal Networking

The following table summarizes the net revenues of the Personal Networking segment by product category:

	Three months ended March 31,			Six months ended March 31,		
	2001	Change	2000	2001	Change	2000
	(in thousands)					
Net revenues:						
Personal Computing............	$ 67,012	(63)%	$179,290	$142,127	(62)%	$369,38
Personal Imaging..............	11,200	(60)%	28,116	35,919	(39)%	59,29
Digital Infotainment..........	35,185	(52)%	73,140	95,970	(32)%	140,26
Wireless Communications.......	56,321	(41)%	95,958	140,158	(30)%	198,97
	$169,718	(55)%	$376,504	$414,174	(46)%	$767,92
As a percentage of Conexant's total net revenues:						
Personal Computing............	27%		36%	22%		3
Personal Imaging..............	5%		5%	5%		
Digital Infotainment..........	14%		15%	15%		1
Wireless Communications.......	22%		19%	21%		2
	68%		75%	63%		7

Personal Computing product revenues reflect a decline in unit shipments of dial-up modem solutions resulting from the extremely weak consumer/end-user demand for PCs and related peripheral devices, and the excess channel inventory build-up by PC OEMs. Revenues from embedded modem solutions also decreased due to weak consumer demand during the period.

Personal Imaging product revenues principally reflect lower unit shipments of semiconductor products for fax modem applications resulting from a significant slowdown in consumer demand in the United States and Europe, as well as excess channel inventory build-ups by OEMs.

Digital Infotainment product revenues declined due to lower demand for media processing products, including video encoders and decoders, as a result of the overall weakness in demand for consumer PCs, and reduced demand for legacy low-speed modems used in satellite set-top box applications. Net revenues from the strategic broadband communications portfolio, including cable modems and satellite set-top box tuners and demodulators were similarly affected by lower consumer demand and high levels of component inventories at OEMs.

Wireless Communications product revenues reflect an overall softer global demand for digital cellular handsets. Net revenues from digital cellular components, subsystems, and system-level products, primarily for code division multiple access ("CDMA") applications, declined as a result of lower subsidies of new digital cellular handsets by service providers and a slower transition to next-generation phones. The Company also experienced lower sales volume from 900MHz digital cordless telephone chipsets.

Mindspeed Technologies

Net revenues for Mindspeed Technologies for the second quarter of fiscal 2001 reflect the sharply lower end-user demand for networking equipment which has affected Mindspeed Technologies, its customers, and its competitors. ISPs and CLECs have dramatically reduced their investment in network capacity expansion as their business models fail to generate sufficient cash flow. Incumbent local exchange carriers and inter-exchange carriers have also reduced their capital spending. Demand has been further affected by higher-than-normal levels of equipment and component inventories among many OEM, subcontractor, and distributor customers. As a result, Mindspeed Technologies has experienced a steep decline in revenues from its AnyPort(TM) family of multi-service access processors and, to a lesser extent, its high-speed DSL products. The declines were partially offset by increased sales of optical networking, ATM, network processor and T/E carrier products used in network infrastructure equipment for metropolitan and optical backbone networks. For the first six months of fiscal 2001, Mindspeed Technologies net revenues increased slightly compared to the prior year period as strong first quarter sales of optical networking, ATM, network processor and T/E carrier products offset the decline in sales of multi-service access processors.

GROSS MARGIN

	Three months ended March 31,			Six months ended March 3		
	2001	Change	2000	2001	Change	20
			(in thousands)			
Gross margin....................	$(83,165)	(136)%	$232,269	$30,593	(93)%	$464
Percent of net revenues.......	nm		46%	5%		

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nm = not meaningful

Cost of goods sold consists predominantly of purchased materials, labor and overhead (including depreciation) associated with product manufacturing, royalty and other intellectual property costs, warranties and sustaining engineering expenses pertaining to products sold. Gross margins for the fiscal 2001 periods reflect the impact of lower revenues on a base of relatively fixed manufacturing

support costs. Gross margins for the second quarter and first six months of fiscal 2001 also reflect additional inventory reserves of approximately $148.6 million and $206.1 million, respectively. The inventory reserves resulted from the sharply reduced end-customer demand for digital cellular handsets, set-top boxes, PC peripherals and Internet infrastructure equipment. The Company anticipates that its gross margins in the near term will continue to be adversely affected by underutilization of its manufacturing facilities, lower quarterly revenues, and other factors. The Company may also be affected by higher energy costs resulting from the electrical power shortages currently affecting the state of California.

RESEARCH AND DEVELOPMENT

	Three months ended March 31,			Six months ended March 31		
	2001	Change	2000	2001	Change	200
	(in thousands)					
Research and development......	$128,879	29%	$100,095	$247,417	31%	$188,
Percent of net revenues.......	51%		20%	37%		

The Company continues to focus its research and development ("R&D") investment principally in the areas of Internet infrastructure, mobile communications and broadband access. The increase in R&D expenses primarily reflects higher headcount and personnel-related costs of the Company's expanded development efforts and the

accelerated launch of new products. As a result of the acquisition of ten businesses and its recruiting programs, the Company increased its engineering team by more than 340 engineers since March 2000.

SELLING, GENERAL AND ADMINISTRATIVE

	Three months ended March 31,			Six months ended Ma	
	2001	Change	2000	2001	Change
	(in thousands)				
Selling, general and administrative..............	$89,741	36%	$66,024	$170,117	27%
Percent of net revenues.......	36%		13%	26%	

The increase in selling, general and administrative ("SG&A") expenses for the first six months of fiscal 2001 compared to the comparable fiscal 2000 period primarily reflects the addition of the selling, marketing and administrative teams of the businesses acquired in fiscal 2000 and the expansion of the Company's sales and marketing organizations, including an increase in the worldwide sales force to over 330 personnel to support anticipated future sales growth. The increase also reflects the continued development of corporate

infrastructure, including the Company's information systems, human resources and finance teams, partially in support of the planned separation of the Mindspeed Technologies and Personal Networking businesses. SG&A expenses for the second quarter and first six months of fiscal 2001 also reflect provisions of approximately $9.7 million and $12.9 million, respectively, for uncollectible accounts receivable from certain slow-paying customers. The Company expects SG&A expenses, excluding provisions for uncollectible accounts receivable, for the second half of fiscal 2001 to decrease from current levels as a result of its recently-implemented cost-reduction initiatives

AMORTIZATION OF INTANGIBLE ASSETS

	Three months ended March 31,			Six months ended March 31		
	2001	Change	2000	2001	Change	200
			(in thousands)			
Amortization of intangible assets........................	$84,040	nm	$25,337	$166,344	nm	$27,

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nm = not meaningful

The higher amortization expense in the fiscal 2001 periods resulted from the ten business acquisitions completed during fiscal 2000. In connection with these acquisitions, the Company recorded an aggregate of $1.6 billion of identified intangible assets and goodwill. These assets are being amortized over their estimated lives (principally five years). Consequently, the Company expects to record amortization expense related to goodwill and intangible assets in excess of $320 million annually for five years.

RESTRUCTURING CHARGE

During the second quarter of fiscal 2001, the Company announced a number of cost reduction initiatives to align its cost structure with the current business environment. The cost reduction initiatives include workforce reductions, temporary shutdowns of the Company's manufacturing facilities, significant reductions in capital spending, the consolidation of certain facilities, and salary reductions of 10% for the senior management team until the Company returns to profitability. When complete, the Company's worldwide workforce will be reduced by approximately 1,500 full-time employees and an additional 100 contractors, for a total workforce reduction of almost 20 percent.

As a part of its cost reduction initiatives, during the second quarter of fiscal 2001 the Company implemented a 700-employee workforce reduction through involuntary severance programs and a consolidation of certain facilities. As a result of these actions, during the quarter ended March 31, 2001 the Company recorded a restructuring charge of $7.6 million. The charge was based upon estimates of the cost of severance benefits for affected employees and lease cancellation and related costs. The actions reduced the Company's workforce in both the Personal Networking and Mindspeed Technologies segments, including approximately 500 employees in the Company's manufacturing operations.

Activity and liability balances related to the restructuring actions through March 31, 2001 are as follows (in thousands):

	Workforce reductions	Facility closing and other	Total
Charged to costs and expenses............	$ 6,778	$800	$ 7,578
Cash payments...........................	(1,354)	--	(1,354)
Restructuring balance, March 31, 2001....	$ 5,424	$800	$ 6,224

All of the amounts accrued for these actions are expected to be paid within one year. Cash payments to complete the restructuring actions will be funded from available cash reserves and funds from operations, and are not expected to significantly impact the Company's liquidity. The Company anticipates that these actions, when fully implemented, will result in a cost savings of approximately $100 million annually. Initially, the cost savings resulting from these actions is expected to be approximately $25.0 million during the third quarter of fiscal 2001.

In addition, as part of its continuing business reassessment and expense reduction initiatives, the Company is currently exploring strategic alternatives for its digital imaging business and intends to exit its board-level sub-assembly business. In connection with these anticipated actions, the Company expects to record additional charges against earnings in the second half of fiscal 2001.

SEPARATION COSTS

In the second quarter and first six months of fiscal 2001, the Company incurred costs of approximately $4.3 million and $12.2 million, respectively, related to the previously-announced separation of the Company into two independent companies to operate its Mindspeed Technologies and Personal Networking business segments. The Company anticipates that it will incur additional costs in connection with its revised plan for the separation of Mindspeed Technologies and the Personal Networking business.

PURCHASED IN-PROCESS RESEARCH AND DEVELOPMENT

During the first six months of fiscal 2000, the Company recorded charges totaling $145.9 million for the fair value of purchased in-process research and development ("IPRD") in connection with the acquisitions of Maker Communications, Inc. and Microcosm Communications Limited. The charges represent the estimated fair values of the portion of IPRD projects which had been completed at the time of the acquisitions.

DEBT CONVERSION COSTS

During the first six months of fiscal 2001, approximately $255.1 million principal amount of the Company's 4-1/4% Convertible Subordinated Notes due 2006 were converted into approximately 11.0 million shares of common stock at a cost to the Company of $42.6 million.

OTHER INCOME (EXPENSE), NET

	Three months ended March 31,			Six months ended March 31,		
	2001	Change	2000	2001	Change	200
			(in thousands)			
Other income (expense), net...	$(1,021)	(210)%	$932	$(5,377)	(456)%	$1,5

Other expense, net for the second quarter of fiscal 2001 is comprised primarily of interest expense, net of interest income on invested cash balances. Other expense, net for the first six months of fiscal 2001 reflects a $5.0 million write-off of certain non-marketable investments, which management determined to be permanently impaired, and net interest expense on the Company's convertible subordinated notes. Other income, net for the fiscal 2000 periods reflects net interest income principally due to lower amounts of debt outstanding during the periods.

PROVISION (BENEFIT) FOR INCOME TAXES

For the first six months of fiscal 2001, the Company recorded an income tax benefit of $152.2 million (24.5% of pretax loss), which reflects the Company's net loss and the impact of non-deductible debt conversion costs and amortization of intangible assets. In the similar period of fiscal 2000, the Company recorded a provision for income taxes of $50.4 million, which reflects the effect of non-deductible charges for IPRD and amortization of intangible assets relating to acquisitions completed during the period.

EXTRAORDINARY GAIN ON EXTINGUISHMENT OF DEBT

During the first quarter of fiscal 2001, the Company purchased $35.0 million principal amount of its 4% Convertible Subordinated Notes due 2007 at prevailing market prices, resulting in a gain of $11.7 million. Such gain has been presented in the accompanying statement of operations as an extraordinary item, net of incomes taxes of $4.4 million.

ADJUSTED EARNINGS

Adjusted income (loss) before extraordinary item and adjusted income (loss) per share before extraordinary item exclude the amortization of intangible assets and special charges. Special charges excluded from the fiscal 2001 periods include debt conversion costs, the restructuring charge, separation costs, the write-down of certain investments, and stock compensation costs (representing the amortization of the value of unvested in-the-money stock options assumed by Conexant in connection with certain business acquisitions). In addition, adjusted loss before extraordinary item for the fiscal 2001 periods reflects an income tax benefit based upon a 36% tax rate, which the Company anticipates will be its effective tax rate for its fiscal year 2001, excluding the amortization of intangible assets and special charges. These measures of earnings are not in accordance with, or an alternative for, generally accepted accounting principles and may not be consistent with measures used by other companies. However, the Company believes these measures of earnings provide its investors additional insight on its underlying operating results and the Company uses these measures internally to evaluate its operating performance.

Adjusted income (loss) before extraordinary item and adjusted income (loss) per

share before extraordinary item is calculated as follows (in thousands, except per share data):

	Three months ended March 31,		
	2001	2000	
Loss before extraordinary item	$(262,011)	$(132,342)	$(4
Amortization of intangible assets	84,040	25,337	1
Purchased in-process research and development	--	145,900	
Debt conversion costs	--	--	
Restructuring charge	7,578	--	
Separation costs	4,270	--	
Stock compensation	2,219	--	
Write-down of investments	--	--	
Income taxes	(23,550)	8,248	(
Adjusted income (loss) before extraordinary item	$(187,454)	$ 47,143	$(2
Adjusted income (loss) per share before extraordinary item:			
Basic	$ (0.77)	$ 0.23	$
Diluted	$ (0.77)	$ 0.21	$
Shares used per share computation:			
Basic	243,515	205,207	2
Diluted	243,515	239,644	2

LIQUIDITY AND CAPITAL RESOURCES

Cash used in operating activities was $178.5 million for the first six months of fiscal 2001, compared to cash provided by operating activities of $104.3 million for the similar period in fiscal 2000. Operating cash flows for the fiscal 2001 period reflect the Company's net loss of $461.6 million offset by noncash charges (depreciation and amortization and other) of $379.7 million, and net increases in the non-cash components of working capital of $96.6 million.

The fiscal 2001 working capital increases include a $160.6 million decrease in net receivables, principally due to lower quarterly sales. The Company's allowance for doubtful accounts increased by $12.8 million during the fiscal 2001 period, resulting from additional reserves taken for certain slow-paying accounts. The working capital increases also include a $118.7 million increase in net inventories, before the effect of provisions for excess inventories of $206.1 million. The additional inventory reserves resulted from sharply reduced end-customer demand for digital cellular handsets, set-top boxes, PC peripherals and Internet infrastructure equipment. The working capital increase also reflects a reduction of accounts payable of $103.9 million and a decrease in accrued expenses and other current liabilities of $15.9 million resulting from lower materials purchases and decreased capital spending.

Cash used in investing activities of $474.1 million during the first six months of fiscal 2001 included net purchases of marketable securities totaling $253.7

million. Capital expenditures totaled $118.8 million during the fiscal 2001 period, primarily for continued investment in production and test facilities and corporate information systems. In addition, the Company made payments for investments, advances and acquisitions totaling $101.6 million, including a vendor advance of $75.0 million and $14.1 million of equity investments, principally in early-stage communications technology companies. The vendor advance was made pursuant to an agreement under which the Company receives foundry capacity to meet current production requirements and to support anticipated future growth. Cash used in investing activities during the fiscal 2000 period consisted of routine capital expenditures of $160.9 million and payments for investments, advances and acquisitions totaling $119.0 million.

Cash used in financing activities of $54.4 million during the first six months of fiscal 2001 principally consisted of $65.0 million paid in connection with the conversion and repurchase of a portion of the Company's convertible subordinated notes. During the period, approximately $255.1 million principal amount of the Company's 4-1/4% Convertible Subordinated Notes due 2006 were converted into approximately 11.0 million shares of common stock, at a cost to the Company of $42.6 million. Also during the period, the Company purchased $35.0 million principal amount of its 4% Convertible Subordinated Notes due 2007 at prevailing market prices, resulting in an extraordinary gain of $11.7 million. These costs were partially offset by proceeds from the exercise of stock options of $10.6 million. Cash provided by financing activities during the fiscal 2000 period consisted of net proceeds from the issuance of $650 million principal amount of 4% Convertible Subordinated Notes due 2007 and proceeds from the exercise of stock options of $76.6 million.

The Company's principal sources of liquidity are its existing cash reserves and available-for-sale marketable securities and cash generated from operations. Combined cash and cash equivalents and marketable securities at March 31, 2001 totaled $438.5 million compared to $944.4 million at September 30, 2000. Working capital at March 31, 2001 was approximately $818 million compared to $1.3 billion at September 30, 2000. The overall working capital decrease principally reflects cash used in operations and cash payments for capital expenditures, investments and advances, and cash paid in connection with reducing the amounts of the Company's long-term debt.

As a result of its recent operating losses, the Company was not in compliance with certain covenants under its $475 million credit facility which required it to meet certain financial ratios tied to its consolidated EBITDA. Following a period of negotiations between the Company and the lenders under the credit facility, the parties terminated the credit facility effective as of May 8, 2001. The Company has had no borrowings outstanding under the credit facility since June 1999.

While the recent dramatic changes in end-user demand and the continued high levels of channel inventories have reduced visibility into future demand, the Company expects that these and other factors will continue to affect its revenues in the near term. The Company believes that further pressure on gross margin and operating profit will result from underutilization of its manufacturing capacity. Consequently, the Company anticipates that it will continue to experience negative cash flows from operations in the near term. During the second quarter of fiscal 2001, the Company announced a number of expense reduction initiatives, including workforce reductions, temporary shutdowns of the Company's manufacturing facilities, the consolidation of certain facilities, and salary reductions of 10% for senior management. The Company has also reduced its planned capital expenditures based upon its current revenue outlook.

The Company believes that its existing sources of liquidity, along with cash expected to be generated from future operations, will be sufficient to fund operations, research and development efforts, and anticipated capital expenditures for the next twelve months. The Company's manufacturing operations are capital intensive, and the Company will need to return its capital spending to prior levels to maintain its manufacturing capacity, or to obtain sufficient manufacturing capacity to support anticipated future revenue growth. 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 renewed capital expenditures or complete any acquisitions, the Company may seek to obtain additional debt financing or issue additional shares of its common stock. However, there can be no assurance that such financing will be available on terms favorable to the Company, or at all.

CERTAIN BUSINESS RISKS

Our business, financial condition and operating results can be impacted by a number of factors including, but not limited to, those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results.

You should carefully consider and evaluate all of the information in this Report, including the risk factors listed below. Any of these risks could materially and adversely affect our business, financial condition and results of operations, which in turn could materially and adversely affect the price of our common stock or other securities.

We have recently incurred substantial operating losses, and we anticipate additional future losses.

Our net revenues for the first six months of fiscal 2001 were $661 million compared to $1.0 billion for the comparable fiscal 2000 period due to sharply reduced end-customer demand in many of the communications electronics end-markets which our products address. We incurred a loss (before an extraordinary gain) of $469 million for the first six months of fiscal 2001.

In March 2001, we announced a number of expense reduction initiatives and a comprehensive business reassessment focused on leveraging our core capabilities and aligning resources with our highest-growth, highest-margin market opportunities. The expense reduction initiatives include workforce reductions, temporary shutdowns of our manufacturing facilities, significant reductions in capital spending, the consolidation of certain facilities, and salary reductions of 10% for our senior management team until we return to profitability. However, these expense reduction initiatives alone will not return us to profitability. We expect that reduced end-customer demand, underutilization of our manufacturing capacity, changes in our revenue mix and other factors will continue to adversely affect our operating results in the near term and we anticipate incurring additional losses through fiscal 2001. In order to return to profitability, we must achieve substantial revenue growth and we currently face an environment of uncertain demand in the markets our products address. We cannot assure as to whether or when we will return to profitability or whether we will be able to sustain such profitability, if achieved.

We operate in the highly cyclical semiconductor industry, which is subject to significant downturns.

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand.

The industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles (of both semiconductor companies' and their customers' products) and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. We have experienced these conditions in our business in the past, are currently experiencing a significant downturn, and may experience such downturns in the future.

During the first six months of fiscal 2001, we--like many of our customers and competitors--have been adversely impacted by a broad slow-down affecting the technology sector, including most of the communications electronics end-markets which our products address. The impact of weakened end-customer demand has been compounded by higher than normal levels of equipment and component inventories among our OEM, subcontractor and distributor customers. As a result of this sharply reduced demand across our product portfolio, we recorded $206.1 million of inventory reserves in the first six months of fiscal 2001. We expect that reduced end-customer demand, underutilization of our manufacturing capacity, changes in our revenue mix and other factors will continue to adversely affect our operating results in the near term.

In addition, the current environment of weak end-customer demand and high levels of channel inventories has, in some cases, led to delays in payments for our products. During the first six months of fiscal 2001, we recorded $12.9 million of additional provisions for uncollectible accounts receivable from certain slow-paying customers. In the event that our customers delay payments to us, or are unable to pay amounts owed to us, we may incur additional losses on our accounts receivable.

From time to time the semiconductor industry also has experienced periods of increased demand and production capacity constraints. We may experience substantial changes in future operating results due to general semiconductor industry conditions and general economic conditions.

We are subject to intense competition and could lose business to our competitors.

The semiconductor industry in general and the markets in which we compete in particular are intensely competitive. We compete worldwide with a number of United States and international semiconductor manufacturers that are both larger and smaller than us in terms of resources and market share. We currently face significant competition in our markets and expect that intense price and product competition will continue. This competition has resulted and is expected to continue to result in declining average selling prices for our products. We also anticipate that additional competitors will enter our markets as a result of growth opportunities in communications electronics, the trend toward global expansion by foreign and domestic competitors, technological and public policy changes and relatively low barriers to entry in certain markets of the industry. Moreover, as with many companies in the semiconductor industry, customers for certain of our products offer other products that compete with similar products offered by us.

We believe that the principal competitive factors for semiconductor suppliers in our market are:

- time-to-market;

- product performance;
- level of integration;
- price and total system cost;
- compliance with industry standards;
- design and engineering capabilities;
- strategic relationships with customers;
- customer support;
- new product innovation; and
- quality.

The specific bases on which we compete vary by market. We cannot assure you that we will be able to successfully address these factors.

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

- longer operating histories and presence in key markets;
- greater name recognition;
- access to larger customer bases; and
- significantly greater financial, 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.

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

Many of our competitors have combined with each other and consolidated their businesses, including the consolidation of competitors with our customers. This is attributable to a number of factors, including the high-growth nature of the communications electronic industry and the time-to-market pressures on suppliers to decrease the time required for product conception, research and development, sampling and production launch before a product reaches the market. This consolidation trend is expected to continue, since investments, alliances and acquisitions may enable semiconductor suppliers, including us and our competitors, to augment technical capabilities or to achieve faster time-to-market for their products than would be possible solely through internal

development.

Consolidations by industry participants, including in some cases, acquisitions of certain of our customers by our competitors, are creating entities with increased market share, customer base, technology and marketing expertise in markets in which we compete. These developments may significantly and adversely affect our current markets, the markets we are seeking to serve and our ability to compete successfully in those markets.

Our success is dependent upon our ability to timely develop new products and reduce costs.

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

- our ability to anticipate customer and market requirements and changes in technology and industry standards;
- our ability to accurately define new products;
- our ability to timely 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
- market acceptance of our products.

Furthermore, we are required to continually evaluate expenditures for planned product development and to choose among alternative technologies based on our expectations of future market growth. We cannot assure you that we will be able to develop and introduce new or enhanced products in a timely and cost-effective manner, that our products will satisfy customer requirements or achieve market acceptance, or that we will be able to anticipate new industry standards and technological changes. We also cannot assure you that we will be able to respond successfully to new product announcements and introductions by competitors.

In addition, prices of established products may decline, sometimes significantly, over time. We believe that in order to remain competitive we must continue to reduce the cost of producing and delivering existing products at the same time that we develop and introduce new or enhanced products. We cannot assure you that we will be able to continue to reduce the cost of our products to remain competitive.

We may be unable to make the substantial research and development investments required to remain competitive in our business .

The semiconductor industry requires substantial investment in research and development in order to develop and bring to market new and enhanced products. We cannot assure you that we will have sufficient resources to develop new and enhanced technologies and competitive products.

We may not be able to keep abreast of the rapid technological changes in our markets.

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

- rapid technological developments;
- evolving industry standards;
- changes in customer requirements;
- frequent new product introductions and enhancements; and
- short product life cycles with declining prices over the life cycle of the product.

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

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

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

We may have particular difficulty attracting and retaining key personnel during periods of poor operating performance, given the significant use of equity-based compensation by our competitors and us. The loss of the services of one or more of our key employees, including Dwight W. Decker, our Chairman and Chief Executive Officer, or certain key design and technical personnel, or our inability to attract, retain and motivate qualified personnel could have a material adverse effect on our ability to operate our business.

If OEMs of communications electronics products do not design our products into their equipment, we will have difficulty selling 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 OEMs of communications electronics products to select our products from among alternative offerings to be designed into their equipment. Without these "design wins" from OEMs, we would have difficulty selling our products. Once an OEM designs another supplier's semiconductors into its products, it will be more difficult for us to achieve future design wins with that OEM's product platform because changing suppliers involves significant cost, time, effort and risk. Achieving a design win with a customer does not ensure that we will receive significant revenues from that customer. 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, for example, if its own products are not commercially successful or for any other reason. We may be unable to achieve design wins or to convert design wins into actual sales.

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

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

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

Our sales are typically made pursuant to individual purchase orders and we generally do not have long-term supply arrangements with our customers. Generally, our customers may cancel orders until 30 days prior to shipment. In addition, we sell a portion of our products through distributors, some of whom have rights to return unsold products to us. Sales to distributors accounted for approximately 19% of fiscal 2000 net revenue and 28% of net revenue in the first six months of fiscal 2001. We routinely purchase inventory based on estimates of customer demand for their products, which is difficult to predict. This difficulty may be compounded when we sell to OEMs indirectly through distributors or contract manufacturers, or both, as our forecasts of demand are then based on estimates provided by multiple parties. In addition, our customers may change their inventory practices on short notice for any reason. The cancellation or deferral of product orders, the return of previously sold products or overproduction due to the failure of anticipated orders to materialize could result in our holding excess or obsolete inventory, which could result in write-downs of inventory.

Recently, the communications electronics markets which we address have been characterized by dramatic changes in end-user demand and continued high levels of channel inventories which have reduced visibility into future demand for our products. We expect that these and other factors will continue to affect our revenues in the near term. As a result of sharply reduced demand across our product portfolio, we recorded $206.1 million of inventory reserves in the first six months of fiscal 2001.

Our manufacturing process is extremely complex and specialized.

Our manufacturing operations are complex and subject to disruption due to causes beyond our control. The fabrication of integrated circuits is an extremely complex and precise process consisting of hundreds of separate steps. It requires production in a highly controlled, clean environment. Minute impurities, errors in any step of the fabrication process, defects in the masks used to print circuits on a wafer or a number of other factors can cause a substantial percentage of wafers to be rejected or numerous die on each wafer not to function.

Our operating results are highly dependent upon our ability to produce large volumes of integrated circuits at acceptable manufacturing yields. Our operations may be affected by lengthy or recurring disruptions of operations at any of our production facilities or those of our subcontractors. These disruptions may include labor strikes, work stoppages, electrical power outages, fire, earthquake, flooding or other natural disasters. These disruptions could cause significant delays in shipments until we could shift the products from an

affected facility or subcontractor to another facility or subcontractor.

In the event of these types of delays, we cannot assure you that the required alternate capacity, particularly wafer production capacity, would be available on a timely basis or at all. Even if alternate wafer production capacity is available, we may not be able to obtain it on favorable terms, which could result in a loss of customers. We may be unable to obtain sufficient manufacturing capacity to meet demand, either at our own facilities or through foundry or similar arrangements with others. Certain of our manufacturing facilities are located near major earthquake fault lines, including our California and Mexico facilities. We maintain only minimal earthquake insurance coverage on these facilities.

Due to the highly specialized nature of the gallium arsenide semiconductor manufacturing process, in the event of a disruption at our Newbury Park, California wafer fabrication facility, alternate gallium arsenide production capacity would not be readily available from third-party sources. Although we have a multi-year agreement with a foundry that guarantees us access to additional gallium arsenide wafer production capacity, a disruption of operations at our Newbury Park wafer fabrication facility or the interruption in the supply of epitaxial wafers used in our gallium arsenide process could have a material adverse effect on our business, financial condition and results of operations, particularly with respect to our Wireless Communications products.

Our long-term revenue growth is also dependent on our ability to achieve a balance of internal and external manufacturing capacity, including wafer production capacity. During times when the semiconductor industry is experiencing an excess of wafer fabrication capacity, we are at a relative disadvantage when compared to some of our competitors who rely primarily on outside foundries because our wafer fabrication facilities require substantial fixed costs and investment. We have recently entered into agreements with outside foundries to secure external wafer manufacturing capacity, including additional gallium arsenide wafer production capacity. During times of limited capacity, internal wafer fabrication facilities ensure that we have access to manufacturing capacity. We continue to explore wafer manufacturing alternatives, which may include increased use of outside foundries, entering into new or expanded business relationships with respect to wafer manufacturing or other actions related to our wafer manufacturing facilities. We cannot assure you that we will be successful in implementing any of these alternatives.

We may not be able to achieve manufacturing yields that contribute positively to our gross margin and profitability.

Minor deviations in the manufacturing process can cause substantial manufacturing yield loss, and in some cases, cause production to be suspended. Manufacturing yields for new products initially tend to be lower as we complete product development and commence volume manufacturing, and will typically increase as we ramp to full production. Our forward product pricing includes this assumption of improving manufacturing yields and, as a result, material variances between projected and actual manufacturing yields have a direct effect on our gross margin and profitability. The difficulty of forecasting manufacturing yields accurately and maintaining cost competitiveness through improving manufacturing yields will continue to be magnified by the ever-increasing process complexity of manufacturing semiconductor products. Our manufacturing operations also face pressures arising from the compression of product life cycles which requires us to bring new products on line faster and for shorter periods while maintaining acceptable manufacturing yields and quality without, in many cases, reaching the longer-term, high-volume

manufacturing conducive to higher manufacturing yields and declining costs.

We are dependent upon third parties for the supply of raw materials and components.

We believe we have adequate sources for the supply of raw materials and components for our manufacturing needs with suppliers located around the world. Although we currently purchase wafers used in the production of our complementary metal oxide semiconductor ("CMOS") products from one major supplier, such wafers are available from several other suppliers. We are currently dependent on two suppliers for epitaxial wafers used in the gallium arsenide semiconductor manufacturing processes at our Newbury Park, California facility. The number of qualified alternative suppliers for wafers is limited and the process of qualifying a new wafer supplier could require a substantial lead-time. Although we historically have not experienced any significant difficulties in obtaining an adequate supply of raw materials and components necessary for our manufacturing operations, we cannot assure you that we may not lose a significant supplier or that a supplier may be unable to meet performance and quality specifications or delivery schedules.

Our manufacturing operations in California may be adversely affected by power outages in that state.

We have substantial manufacturing operations in California, which may experience electric power outages due to the difficulties being experienced by the electric utility industry in that state. If our California operations were to shut down due to lack of electric power for extended periods, they might be unable to meet customers' delivery schedules, thereby adversely affecting our revenue. In addition, our California operations may experience increased operating expenses due to inefficiencies resulting from irregular interruptions in electric power supply, including penalties and fines as a result of being unable to reduce the power consumption by its manufacturing facilities on short notice in connection with such interruptions. These operations also will incur increased electric power costs in

the future. We are unable to predict how long the difficulties faced by the electric utility industry in California will continue, or how such difficulties will be resolved. To the extent they do continue and our operations experience power outages and/or increases in their cost of electric power, our business could be adversely affected.

We must incur significant capital expenditures for manufacturing technology and equipment to remain competitive.

The semiconductor industry is highly capital intensive. Semiconductor manufacturing requires a constant upgrading of process technology to remain competitive, as new and enhanced semiconductor processes are developed which permit smaller, more efficient and more powerful semiconductor devices. We maintain our own manufacturing, assembly and test facilities, which have required and will continue to require significant investments in manufacturing technology and equipment.

We have made substantial capital expenditures and installed significant production capacity to support new technologies and increased production volume. We made capital expenditures during fiscal 2000 of approximately $315 million, compared to approximately $214 million during fiscal 1999. We expect our capital expenditures for fiscal 2001 will total approximately $190 million.

We cannot assure you that we will have sufficient capital resources to make necessary investments in manufacturing technology and equipment.

Our success depends on our ability to effect suitable investments, alliances or acquisitions.

Although we invest significant resources in research and development activities, the complexity and rapidity of technological changes make it impractical for us to pursue development of all technological solutions on our own. As part of our goal to provide advanced semiconductor product systems, we have and will continue to review on an ongoing basis investment, alliance and acquisition prospects that would complement our existing product offerings, augment our market coverage or enhance our technological capabilities. However, we cannot assure you that we will be able to identify and consummate suitable investment, alliance or acquisition transactions in the future.

Moreover, if we consummate such transactions, they could result in:

- issuances of equity securities dilutive to our existing shareholders;
- large one-time write-offs;
- the incurrence of substantial debt and assumption of unknown liabilities;
- the potential loss of key employees from the acquired company;
- amortization expenses related to goodwill and other intangible assets; and
- the diversion of management's attention from other business concerns.

In fiscal 2000, we recorded charges of $215.7 million for purchased in-process research and development and amortization expenses of $160.2 million for acquisition-related intangible assets, principally related to the ten acquisitions we completed in fiscal 2000. As a result of these acquisitions, we expect to record amortization expense related to goodwill and intangible assets in excess of $320 million annually for five years.

We may have difficulty integrating companies we acquire.

We completed ten acquisitions in fiscal 2000. We evaluate acquisitions on an ongoing basis and we may make additional acquisitions in the future. Integrating acquired organizations and their products and services may be expensive, time-consuming and a strain on our resources. We could face several challenges integrating current and future acquisitions, including:

- the difficulty of integrating acquired technology into our product offerings;
- the impairment of relationships with employees and customers;
- the difficulty of coordinating and integrating overall business strategies and worldwide operations;
- the potential disruption of our ongoing business and distraction of management;

- the inability to maintain brand recognition of acquired businesses;
- the inability to maintain corporate controls, procedures and policies;
- the failure of acquired features, functions, products or services to achieve market acceptance; and
- the potential unknown liabilities associated with acquired businesses.

We cannot assure you that we will be able to address these challenges successfully.

We face a risk that capital needed for our business will not be available when we need it.

Our $475 million credit facility was recently terminated. We did not use it to fund our operations, but it was a source of stand-by liquidity. We believe that cash flows from operations, existing cash reserves and available-for-sale marketable securities will be sufficient to satisfy our research and development, capital expenditure, working capital and other financing requirements for the next twelve months. However, we cannot assure you that this will be the case. We may need to obtain alternate sources of financing, such as another credit facility, in the future. We cannot assure you that we will have access to additional sources of capital on favorable terms or at all.

In addition, we have and will continue to review, on an ongoing basis, strategic investments and acquisitions, which will help us grow our business. These investments and acquisitions may require additional capital resources. We cannot assure you that the capital required to fund these investments and acquisitions will be available in the future.

We are subject to the risks of doing business internationally.

For fiscal 2000 and the first six months of fiscal 2001, approximately 70 percent and 65 percent, respectively, of our net revenues were from customers located outside the United States, primarily in the Asia-Pacific and European countries. In addition, we have facilities and suppliers located outside the United States, including our assembly and test facility in Mexicali, Mexico and third-party foundries located in the Asia-Pacific region. Our international sales and operations are subject to a number of risks inherent in selling and operating abroad. These include, but are not limited to, risks regarding:

- currency exchange rate fluctuations;
- local economic and political conditions;
- disruptions of capital and trading markets;
- restrictive governmental actions (such as restrictions on transfer of funds and trade protection measures, including export duties and quotas and customs duties and tariffs);

- changes in legal or regulatory requirements;
- limitations on the repatriation of funds;

- difficulty in obtaining distribution and support;

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

- tax laws; and

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

Because most of our international sales, other than sales to Japan (which are denominated principally in Japanese yen), are currently denominated in U.S. dollars, our products could become less competitive in international markets if the value of the U.S. dollar increases relative to foreign currencies. Moreover, we may be competitively disadvantaged relative to our competitors located outside the United States who may benefit from a devaluation of their local currency. We cannot assure you that the factors described above will not have a material adverse effect on our ability to increase or maintain our foreign sales.

Our past operating performance has been impacted by adverse economic conditions in the Asia-Pacific region, which have increased the uncertainty with respect to the long-term viability of certain of our customers and suppliers in the region. Sales to customers in Japan and other countries in the Asia-Pacific region, principally Taiwan, South Korea and Hong Kong, represented approximately 57 percent and 49 percent, respectively, of our net revenues in fiscal 2000 and the first six months of fiscal 2001.

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

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

Our revenues, earnings and other 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;

- production capacity levels and fluctuations in manufacturing yields;

- availability and cost of products from our suppliers;

- the gain or loss of significant customers;

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

- new product and technology introductions by competitors;

- changes in the mix of products produced and sold;

- market acceptance of our products and our customers' products;

- intellectual property disputes;
- seasonal customer demand;
- the timing of receipt, reduction or cancellation of significant orders by customers; and
- the timing and extent of product development costs.

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

The value of our common stock may be adversely affected by market volatility.

The trading price of our common stock fluctuates significantly. Since our common stock began trading publicly, the reported sale price of our common stock on the NASDAQ National Market has been as high as $132.50 and as low as $6.84 per share. This price may be influenced by many factors, including:

- our performance and prospects;
- the depth and liquidity of the market for our common stock;
- investor perception of Conexant and the industry in which we operate;
- 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 are currently experiencing, extreme price and trading volume volatility, particularly in high 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.

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

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. From time to time, third parties may assert patent, copyright, trademark and other intellectual property rights to technologies that are important to our business and may demand that we license their technology. Any litigation to determine the validity of claims that our products infringe or may infringe these rights, including claims arising through our contractual indemnification of our customers, regardless of their merit or resolution, could be costly and divert the efforts and attention of our

management and technical personnel. We cannot assure you that we would prevail in litigation given the complex technical issues and inherent uncertainties in intellectual property litigation. If litigation results in an adverse ruling we could be required to:

- pay substantial damages;
- cease the manufacture, use or sale of infringing products;
- discontinue the use of infringing technology;
- expend significant resources to develop non-infringing technology; or
- license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all.

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 nondisclosure and confidentiality agreements and other methods, to protect our proprietary technologies and processes. In addition, we often incorporate the intellectual property of our customers into our designs, and we have obligations with respect to the non-use and non-disclosure of their intellectual property. In the past, we have found it necessary to engage in litigation to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of proprietary rights of others, including our customers. We expect future litigation on similar grounds, which may require us to expend significant resources and to divert the efforts and attention of our management from our business operations. We cannot assure you that:

- the steps we take to prevent misappropriation or infringement of our intellectual property or the intellectual property of our customers will be successful;
- any existing or future patents will not be challenged, invalidated or circumvented; or
- any of the measures described above would provide meaningful protection.

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

We may be liable for penalties under environmental laws, rules and regulations, which could adversely impact our business.

We use a variety of chemicals in our manufacturing operations and are subject to a wide range of environmental protection regulations in the United States, Mexico and Canada. While we have not experienced any material adverse effect on our operations as a result of such regulations, we cannot assure you that current or future regulations would not have a material adverse effect on our business, financial condition and results of operations.

In the United States, environmental regulations often require parties to fund remedial action regardless of fault. Consequently, it is often difficult to estimate the future impact of environmental matters, including potential liabilities. We cannot assure you that the amount of expense and capital expenditures that might be required to complete remedial actions and to continue to comply with applicable environmental laws will not have a material adverse effect on our business, financial condition and results of operations.

We have been designated as a potentially responsible party at one Superfund site located at a former silicon wafer manufacturing facility and steel fabrication plant in Parker Ford, Pennsylvania formerly occupied by the semiconductor systems business of Rockwell. The site was also formerly occupied by Recticon Corporation and Allied Steel Products Corporation, each of whom has also been named as a potentially responsible party and each of whom is insolvent. We have accrued approximately $2.1 million at March 31, 2001 for the cost of groundwater remediation, including installation of a public water supply line and groundwater pump and treatment system, as well as routine groundwater sampling. In addition, we are engaged in two other remediations of groundwater contamination at our Newport Beach and Newbury Park, California facilities for which we have accrued approximately $2.3 million for the costs of remediation at March 31, 2001. Pursuant to our agreement with Rockwell, we have assumed liabilities in respect of environmental matters related to current and former operations of Conexant.

Our management team may be subject to a variety of demands for its attention.

Our management currently faces a variety of challenges, including the implementation of our expense reduction and restructuring initiatives, the integration of recently-acquired businesses and the anticipated separation of the Personal Networking and Mindspeed Technologies businesses. While we believe that we have sufficient management resources to execute each of these initiatives, we cannot assure you that we will have these resources or that our initiatives will be successfully implemented.

Certain provisions in our organizational documents and rights agreement and Delaware law may make it difficult for someone to acquire control of Conexant.

We have established certain anti-takeover measures that may affect our common stock and convertible notes. Our restated certificate of incorporation, our by-laws, our rights agreement with Mellon Investor Services LLC, as rights agent, dated as of November 30, 1998, as amended, and the Delaware General Corporation Law contain several provisions that would make more difficult an acquisition of control of Conexant in a transaction not approved by our board of directors. Our restated certificate of incorporation and by-laws 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 shareowners;
- a prohibition on shareowner action by written consent;
- a requirement that shareowners provide advance notice of any shareowner nominations of directors or any proposal of new business to be

considered at any meeting of shareowners;

- 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 by-laws;

- elimination of the right of shareowners to call a special meeting of shareowners; and

- a fair price provision.

We also have a rights agreement which gives our shareowners 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 by-laws, Section 203 of the Delaware General Corporation Law generally provides that a corporation shall not engage in any business combination with any interested shareowner during the three-year period following the time that such shareowner becomes an interested shareowner, unless a majority of the directors then in office approves either the business combination or the transaction that results in the shareowner becoming an interested shareowner or specified shareowner approval requirements are met.

We may be responsible for certain federal income tax liabilities that relate to our spin-off from Rockwell.

In connection with our spin-off from Rockwell, the Internal Revenue Service issued a tax ruling to Rockwell stating that the spin-off would qualify as a tax-free reorganization within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code of 1986, as amended. While the tax ruling generally is binding on the Internal Revenue Service, the continuing validity of the tax ruling is subject to certain factual representations and assumptions. We are not aware of any facts or circumstances that would cause such representations and assumptions to be untrue.

The Tax Allocation Agreement dated as of December 31, 1998 between Conexant and Rockwell provides that we will be responsible for any taxes imposed on Rockwell, Conexant or Rockwell shareowners as a result of either:

- the failure of the spin-off from Rockwell to qualify as a tax-free reorganization within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code or

- the subsequent disqualification of the spin-off from Rockwell as a tax-free transaction to Rockwell under Section 361(c)(2) of the Internal Revenue Code,

if the failure or disqualification is attributable to certain post-spin-off actions by or in respect of Conexant (including our subsidiaries) or our shareowners, such as our acquisition by a third party at a time and in a manner that would cause such failure or disqualification.

The Tax Allocation Agreement also provides, among other things, that neither Rockwell nor Conexant is to take any action inconsistent with, nor fail to take any action required by, the request for the tax ruling or the tax ruling unless:

- required to do so by law;

- the other party has given its prior written consent; or
- in certain circumstances, a supplemental ruling permitting such action is obtained.

Rockwell and Conexant have indemnified each other for any tax liability resulting from each entity's failure to comply with these provisions.

In addition, we effected certain tax-free intragroup spin-offs as a result of Rockwell's spin-off of Meritor Automotive, Inc. (now ArvinMeritor, Inc.) on September 30, 1997. The Tax Allocation Agreement provides that we will be responsible for any taxes imposed on Rockwell, Conexant or Rockwell shareowners in respect of those intragroup spin-offs if such taxes are attributable to certain actions taken after the spin-off from Rockwell by or in respect of Conexant (including our subsidiaries) or our shareowners, such as our acquisition by a third party at a time and in a manner that would cause the taxes to be incurred.

If we were required to pay any of the taxes described above, such payments would be very substantial.

CAUTIONARY STATEMENT

This Quarterly Report contains statements relating to future results of the Company (including certain projections and business trends) that are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: global economic and market conditions, including the cyclical nature of the semiconductor industry and the markets addressed by the Company's and its customers' products; demand for and market acceptance of new and existing products; successful development of new products; the timing of new product introductions; the successful integration of acquisitions; the availability and extent of utilization of manufacturing capacity and raw materials; pricing pressures and other competitive factors; changes in product mix; fluctuations in manufacturing yields; product obsolescence; the ability to develop and implement new technologies and to obtain protection of the related intellectual property; the successful implementation of the Company's expense reduction and restructuring initiatives; the successful separation of the Company's Mindspeed Technologies and Personal Networking businesses; labor relations of the Company, its customers and suppliers; the Company's ability to attract and retain qualified personnel; maintaining a consistent and reliable source of energy; and the uncertainties of litigation, as well as other risks and uncertainties including those set forth herein and those detailed from time to time in the filings of the Company with the Securities and Exchange Commission. These forward-looking statements are made only as of the date hereof, and the Company undertakes no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's financial instruments include cash and cash equivalents, marketable securities and long-term debt. The Company's main investment objectives are the preservation of investment capital and the maximization of after-tax returns on its investment portfolio. Consequently, the Company invests

in debt securities only of high-credit-quality issuers and limits the amount of credit exposure to any one issuer. The Company's marketable equity securities consist of an investment initially entered into for the promotion of business and strategic objectives. The Company does not use derivative instruments for speculative or investment purposes.

The Company's cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of March 31, 2001, the carrying value of the Company's cash and cash equivalents approximated fair value. The Company's marketable debt securities (consisting of corporate and government securities) principally have remaining terms of in excess of one year. Consequently, such securities are subject to interest rate risk. Marketable equity securities consist of an equity investment in a semiconductor company, initially made for the promotion of business and strategic objectives, which is subject to equity price risk.

All of the Company's marketable securities are classified as available for sale and, as of March 31, 2001, unrealized gains of $15.3 million (net of related income taxes of $9.3 million) on these securities are included in accumulated other comprehensive income. A 10% adverse change in equity prices would result in an approximate $3.7 million decrease in the fair value of the Company's marketable equity securities as of March 31, 2001.

The Company's long-term debt consists of convertible subordinated notes with interest at fixed rates. Consequently, the Company does not have significant cash flow exposure on its long-term debt. However, the fair value of the convertible subordinated notes is subject to significant fluctuation due to their convertibility into shares of the Company's common stock.

The following table shows the fair values of the Company's investments and long-term debt as of March 31, 2001 (in thousands):

	Carrying Value	Fair Value
Cash and equivalents	$124,144	$124,144
Marketable debt securities	277,682	277,682
Marketable equity securities (including unrealized gains of $21.3 million).......	36,683	36,683
Long-term debt	709,849	391,878

The Company transacts business in various foreign currencies, and is subject to certain foreign exchange risks, principally arising from customer accounts receivable at its Japanese subsidiary which are denominated in yen. At March 31, 2001, such receivables totaled approximately $15.0 million. The Company is also subject to foreign exchange risks relating to certain purchase commitments, principally denominated in euros. The Company has established a foreign currency hedging program utilizing foreign currency forward exchange contracts to hedge certain of its foreign currency transaction exposures (principally to the euro and the Japanese yen). Under this program, the Company seeks to offset foreign currency transaction gains and losses with gains and losses on the forward contracts, so as to mitigate its overall risk of foreign transaction gains and losses. The Company does not enter into forward contracts for speculative or trading purposes.

The table below provides information about the Company's foreign currency forward exchange contracts as of March 31, 2001. The table presents the notional amounts (the U.S. dollar equivalent, based on the contract exchange rates) and the contract foreign currency exchange rates.

	Notional Amount	Contract Rate Per US$1.00	Estimated Fair Value
	(dollars in thousands)		
Buy (Sell):			
Euro........................	$ 10,926	0.917	$(462)
Japanese yen.................	$ (6,111)	114.8	$ 497

Based on the Company's overall currency rate exposure at March 31, 2001, a 10 percent change in currency rates would not have a significant effect on the consolidated financial position, results of operations or cash flows of the Company.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On July 29, 1991, Shumpei Yamazaki filed suit against a Japanese subsidiary of Rockwell in the Tokyo District Court, Twenty-ninth Civil Division for patent infringement relating to Conexant's facsimile modem chipsets seeking 685 million yen (approximately $5.6 million based on the exchange rate on April 27, 2001) and court costs. In October 1998, the District Court rendered its decision dismissing the suit against Conexant, from which decision Mr. Yamazaki appealed. On April 12, 1999, Mr. Yamazaki presented his position, as well as additional causes of action at the first portion of the appellate hearing. The Tokyo High Court rejected Mr. Yamazaki's additional claims and set the calendar for appellate hearings. In February 2001, the three-judge Tokyo High Court panel asked for argument on damages, with the next hearing scheduled for May 23, 2001. Conexant believes it has meritorious defenses to Mr. Yamazaki's infringement and damages claims, and is vigorously defending this action.

On May 30, 1997, Klaus Holtz filed suit against Rockwell in the U.S. District Court for the Northern District of California for patent infringement relating to Conexant's modem products utilizing the V.42bis standard for data compression. On September 30, 1998, the Court barred any alleged damages arising before May 30, 1997. On December 17, 1998, the Court issued an order construing the claims of the patent. Conexant filed a motion for Summary Judgment of Non-Infringement on February 22, 1999. A hearing was held thereon on June 14, 1999. On October 25, 1999, the Court found in favor of Conexant and the case was dismissed. On July 10, 2000, the District Court granted Conexant's motion to declare the case an exceptional case under 35 U.S.C. 285, and awarded Conexant $250,000. Holtz filed a notice of appeal to the court of appeals for the Federal Circuit, challenging the District Court's findings on claim construction, non-infringement and laches. Conexant began collection efforts on the approximately $275,000 owed to Conexant by Holtz as a result of the litigation so far. On August 22, 2000, Holtz filed for bankruptcy protection under Chapter 7 of the bankruptcy laws in the State of California. The Federal Circuit appeals were placed under the control of the trustee in bankruptcy, and were stayed

pending resolution of the bankruptcy. Conexant has reached an agreement with the bankruptcy trustee, wherein Holtz' appeals against Conexant will be dismissed and Conexant will receive a license under Holtz' patents. This agreement is subject to, and the Company is waiting for, approval of the Bankruptcy Court.

Various other lawsuits, claims and proceedings have been or may be instituted or asserted against Rockwell or Conexant or their respective subsidiaries, including those pertaining to product liability, intellectual property, environmental, safety and health, and employment matters. In connection with the Company's spin-off from Rockwell, Conexant assumed responsibility for all then current and future litigation (including environmental and intellectual property proceedings) against Rockwell or its subsidiaries in respect of the operations of the semiconductor systems business of Rockwell.

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

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

The Company's annual meeting of shareowners was held on February 28, 2001 in New York, New York. At the meeting, the following matters were voted on by the Company's shareowners:

	For	Against	Wi Abs B no
Election of directors:			
Donald R. Beall	198,024,866	--	4,
Jerre L. Stead	198,665,290	--	3,
Proposal to ratify the appointment of Deloitte & Touche LLP as independent auditors for the Company	199,975,200	914,307	1,

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

12 -- Statement re: Computation of Ratios

(b) Reports on Form 8-K

Report on Form 8-K filed March 27, 2001, reporting expense reduction initiatives and the expectation of lower second fiscal quarter revenues (Items 5 and 7).

SIGNATURES

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

CONEXANT SYSTEMS, INC.
(Registrant)

Date: May 8, 2001

By /s/ Balakrishnan S. Iyer

Balakrishnan S. Iyer
Senior Vice President and
Chief Financial Officer
(principal financial officer)

Date: May 8, 2001

By /s/ J. Scott Blouin

J. Scott Blouin
Vice President and
Chief Accounting Officer
(principal accounting officer)

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
12	Statement re: Computation of Ratios