LSI CORP
Form 10-Q
August 12, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended July 4, 2010

OR

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

For the transition period from __________ to __________

Commission File Number: 1-10317

LSI CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**94-2712976**
(State of Incorporation)	***(I.R.S. Employer Identification Number)***

1621 Barber Lane
Milpitas, California 95035
(Address of principal executive offices)
(Zip code)
(408) 433-8000
(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

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

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

As of August 9, 2010, there were 641,842,588 shares of the registrant s Common Stock, $.01 par value, outstanding.

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Form 10-Q
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FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words estimate, plan, intend, expect, anticipat believe and similar words are intended to identify forward-looking statements. Although we believe our expectations are based on reasonable assumptions, our actual results could differ materially from those projected in the forward-looking statements. We have described in Part II, Item 1A. Risk Factors a number of factors that could cause our actual results to differ from our projections or estimates. Except where otherwise indicated, the statements made in this report are made as of the date we filed this report with the Securities and Exchange Commission and should not be relied upon as of any subsequent date. We expressly disclaim any obligation to update the information in this report, except as may otherwise be required by law.

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

LSI CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(Unaudited)

	July 4, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	$ 511,377	$ 778,291
Short-term investments	158,481	183,781
Accounts receivable, less allowances of $9,388 and $9,902, respectively	307,074	338,961
Inventories	191,582	169,335
Prepaid expenses and other current assets	110,479	115,084
Total current assets	1,278,993	1,585,452
Property and equipment, net	212,836	218,972
Identified intangible assets, net	658,772	739,244
Goodwill	188,698	188,698
Other assets	224,756	235,564
Total assets	$ 2,564,055	$ 2,967,930
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 194,093	$ 213,008
Accrued salaries, wages and benefits	99,264	77,281
Other accrued liabilities	196,217	214,096
Current portion of long-term debt		350,000
Total current liabilities	489,574	854,385
Pension and post-retirement benefit obligations	443,763	454,206
Income taxes payable non-current	82,150	103,047
Other non-current liabilities	83,908	95,188
Total liabilities	1,099,395	1,506,826
Commitments and contingencies (Note 13)		
Stockholders equity:		
Preferred stock, $.01 par value: 2,000 shares authorized; none outstanding		
Common stock, $.01 par value: 1,300,000 shares authorized; 647,694 and 656,484 shares outstanding, respectively	6,477	6,565
Additional paid-in capital	6,117,336	6,142,674
Accumulated deficit	(4,378,542)	(4,408,494)
Accumulated other comprehensive loss	(280,611)	(279,641)
Total stockholders equity	1,464,660	1,461,104

Total liabilities and stockholders equity	$ 2,564,055	$ 2,967,930

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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LSI CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 4, 2010	July 5, 2009	July 4, 2010	July 5, 2009
Revenues	$ 639,405	$ 520,665	$ 1,276,587	$ 1,002,944
Cost of revenues	363,774	339,772	729,711	651,979
Gross profit	275,631	180,893	546,876	350,965
Research and development	171,153	148,919	338,025	304,203
Selling, general and administrative	85,811	81,727	172,143	165,484
Restructuring of operations and other items, net	5,067	6,010	6,687	31,215
Income/(loss) from operations	13,600	(55,763)	30,021	(149,937)
Interest expense	(1,707)	(6,864)	(5,601)	(14,100)
Interest income and other, net	4,639	6,344	(4,168)	12,207
Income/(loss) before income taxes	16,532	(56,283)	20,252	(151,830)
Provision/(benefit) for income taxes	9,100	5,200	(9,700)	13,200
Net income/(loss)	$ 7,432	$ (61,483)	$ 29,952	$ (165,030)
Net income/(loss) per share:				
Basic	$ 0.01	$ (0.09)	$ 0.05	$ (0.25)
Diluted	$ 0.01	$ (0.09)	$ 0.05	$ (0.25)
Shares used in computing per share amounts:				
Basic	651,778	650,300	654,192	649,360
Diluted	661,540	650,300	663,857	649,360

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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LSI CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended July 4, 2010	July 5, 2009
Operating activities:		
Net income/(loss)	$ 29,952	$ (165,030)
Adjustments:		
Depreciation and amortization	133,268	131,318
Stock-based compensation expense	34,926	34,992
Gain on redemption of convertible subordinated notes		(149)
Write-down of equity securities	11,600	
Loss on sale of property and equipment	268	117
Unrealized foreign exchange loss/(gain)	990	(8,116)
Deferred taxes	183	(11)
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Accounts receivable, net	31,887	36,054
Inventories	(22,247)	73,582
Prepaid expenses and other assets	6,343	43,458
Accounts payable	(14,410)	(53,388)
Accrued and other liabilities	(39,365)	(33,762)
Net cash provided by operating activities	173,395	59,065
Investing activities:		
Purchases of debt securities available-for-sale	(1,189)	(10)
Proceeds from maturities and sales of debt securities available-for-sale	21,525	63,945
Purchases of equity securities	(316)	(5,000)
Purchases of property, equipment and software	(48,373)	(48,601)
Proceeds from sale of property and equipment	199	112
Acquisition of businesses and companies, net of cash acquired		(20,840)
Decrease in non-current assets and deposits		13,501
Net cash (used in)/provided by investing activities	(28,154)	3,107
Financing activities:		
Redemption of convertible subordinated notes		(244,047)
Repayment of debt obligations	(349,999)	
Issuances of common stock	21,588	6,673
Purchase of common stock under repurchase program	(80,732)	
Net cash used in financing activities	(409,143)	(237,374)
Effect of exchange rate changes on cash and cash equivalents	(3,012)	855

Net change in cash and cash equivalents	(266,914)	(174,347)
Cash and cash equivalents at beginning of period	778,291	829,301
Cash and cash equivalents at end of period	$ 511,377	$ 654,954

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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LSI CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Basis of Presentation

For financial reporting purposes, LSI Corporation (LSI or the Company) reports on a 13- or 14-week quarter with a year ending December 31. The second quarter of 2010 and 2009 consisted of 13 weeks each and ended on July 4, 2010 and on July 5, 2009, respectively. The first six months of 2010 and 2009 consisted of approximately 26 weeks each. The results of operations for the quarter ended July 4, 2010 are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

In management s opinion, the accompanying unaudited condensed consolidated financial statements contain all normal recurring adjustments necessary to state fairly the financial information included herein. While the Company believes that the disclosures are adequate to make the information not misleading, these financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

Recent Accounting Pronouncements

Pronouncements not yet effective:

In October 2009, the Financial Accounting Standards Board (FASB) issued guidance on multiple-deliverable arrangements to address how to separate deliverables and how to measure and allocate arrangement consideration. This guidance requires vendors to develop the best estimate of selling price for each deliverable and allocate the arrangement consideration using this selling price. This guidance also expands the disclosure requirements to include both quantitative and qualitative information. This guidance is effective for fiscal years beginning after June 15, 2010. The Company is currently evaluating the impact of the adoption of this guidance on its results of operations and financial position.

In October 2009, the FASB issued guidance to clarify that tangible products containing software components and non-software components that function together to deliver a product s essential functionality will be considered non-software deliverables and will be scoped out of the software revenue recognition guidance. This guidance is effective for the fiscal years beginning after June 15, 2010. The Company is currently evaluating the impact of the adoption of this guidance on its results of operations and financial position.

Pronouncements adopted during the six months ended July 4, 2010:

In June 2009, the FASB issued guidance that amends the consolidation rules related to variable interest entities. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. This guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary of the variable interest entity. This guidance is effective for fiscal years beginning after November 15, 2009. The Company adopted this guidance in the first quarter of 2010. The adoption did not impact the Company s results of operations or financial position.

In January 2010, the FASB issued guidance that expands the interim and annual disclosure requirements of fair value measurements, including information about the movement of assets between levels 1 and 2 of the three-tier fair value hierarchy established under fair value measurement guidance. Separate disclosure is required for purchases, sales, issuances and settlements in the reconciliation for fair value measurements for level 3 assets. Except for the detailed disclosure in the level 3 reconciliation, which is effective for fiscal years beginning after December 15, 2010, all the other disclosures under this guidance are effective for fiscal years beginning after December 15, 2009. The Company adopted this guidance in the first quarter of 2010.

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Note 2 Stock-Based Compensation and Common Stock

Stock-Based Compensation Expense

The following table summarizes stock-based compensation expense, net of estimated forfeitures, related to the Company s stock options, the Employee Stock Purchase Plan (ESPP) and restricted stock unit awards:

Stock-Based Compensation Expense Included In:	Three Months Ended July 4, 2010	Three Months Ended July 5, 2009	Six Months Ended July 4, 2010	Six Months Ended July 5, 2009
	(In thousands)			
Cost of revenues	$ 2,292	$ 2,022	$ 4,004	$ 4,035
Research and development	8,644	7,195	16,542	15,057
Selling, general and administrative	7,559	7,785	14,380	15,900
Total stock-based compensation expense	$ 18,495	$ 17,002	$ 34,926	$ 34,992

Stock Options:

The fair value of each option grant is estimated as of the date of grant using a reduced-form calibrated binominal lattice model (the lattice model). The following table summarizes the weighted-average assumptions that the Company applied in the lattice model:

	Three Months Ended July 4, 2010	Three Months Ended July 5, 2009	Six Months Ended July 4, 2010	Six Months Ended July 5, 2009
Estimated grant date fair value per share	$ 2.05	$ 1.89	$ 1.97	$ 1.37
Expected life (years)	4.35	4.29	4.28	4.29
Risk-free interest rate	2%	2%	2%	2%
Volatility	54%	66%	51%	68%

The following table summarizes changes in stock options outstanding during the six month period ended July 4, 2010:

	Number of Shares (In thousands)	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding at December 31, 2009	91,526	$ 9.83		
Options granted	7,014	5.50		
Options exercised	(1,457)	4.05		
Options canceled	(3,093)	64.20		
Options outstanding at July 4, 2010	93,990	$ 7.81	3.78	$ 29,395
Options exercisable at July 4, 2010	56,113	$ 9.71	2.76	$ 6,755

Employee Stock Purchase Plan:

Compensation expense for the Company s ESPP is calculated using the fair value of the employees purchase rights under the Black-Scholes model. Under the ESPP, rights to purchase shares are granted during the second and fourth quarters of each year. A total of 3.3 million shares and 2.5 million shares were issued under the ESPP during the three months ended July 4, 2010 and July 5, 2009, respectively. The following table summarizes the weighted-average assumptions that went into the calculation of the fair value for May 2010 and May 2009 grants:

	Three Months Ended	
	July 4, 2010	July 5, 2009
Estimated grant date fair value per share	$1.74	$1.39
Expected life (years)	0.8	0.5
Risk-free interest rate	0.3%	0.3%
Volatility	48%	78%

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Restricted Stock Awards:

Service-based:

The following table summarizes changes in service-based restricted stock units outstanding during the six months ended July 4, 2010:

	Number of Units (In thousands)
Unvested service-based restricted stock units at December 31, 2009	2,986
Granted	6,481
Vested	(812)
Forfeited	(100)
Unvested service-based restricted stock units at July 4, 2010	8,555

The cost of service-based restricted stock unit awards is determined using the fair value of the Company s common stock on the date of grant. The vesting requirements for these restricted stock units are determined at the time of grant and require that the employees remain employed by the Company. As of July 4, 2010, the total unrecognized compensation expense related to these restricted stock units, net of estimated forfeitures, was $37.8 million and is expected to be recognized over the next 3 years on a weighted-average basis. The fair value of the shares that were issued upon the vesting of restricted stock units during the three and six months ended July 4, 2010 was $0.2 million and $4.5 million, respectively.

Performance-based:

During the six months ended July 4, 2010, the Company granted performance-based restricted stock units. The vesting of these performance-based restricted stock units is contingent upon the Company meeting certain performance criteria and the employees continuing service to the Company. As of July 4, 2010, the total unrecognized compensation expense related to performance-based restricted stock units was $13.1 million and, if the contingencies are fully met, is expected to be recognized over the next 1 to 3 years.

The following table summarizes changes in performance-based restricted stock units outstanding during the six months ended July 4, 2010:

	Number of Units (In thousands)
Unvested performance-based restricted stock units at December 31, 2009	
Granted	3,046
Vested	
Forfeited	(48)
Unvested performance-based restricted stock units at July 4, 2010	2,998

Common Stock

Stock Repurchase Program:

On March 17, 2010, the Company announced that its Board of Directors had authorized a stock repurchase program of up to $250.0 million of the Company s common stock in open market or privately negotiated transactions. The Company repurchased 10.1 million shares for $54.5 million in cash during the three months ended July 4, 2010 and 14.1 million shares for $80.7 million in cash during the six months ended July 4, 2010. The repurchased shares were retired immediately after the repurchases were complete. Retirement of the repurchased shares is recorded as a reduction of common stock and additional paid-in capital. As of July 4, 2010, $169.3 million remained available under this stock repurchase program.

Note 3 Restructuring of Operations and Other Items

For the three months ended July 4, 2010, the Company recorded charges of $5.1 million in restructuring of operations and other items, net, consisting of $4.9 million in charges for restructuring of operations and $0.2 million in charges for other items. Of these charges, $4.8 million and $0.3 million were recorded in the Semiconductor segment and the Storage Systems segment, respectively. For the six months ended July 4, 2010, the Company recorded charges of $6.7 million in restructuring of operations and other items, net, consisting of $6.3 million in charges for restructuring of operations and $0.4 million in charges for other items. Of these charges, $6.1 million and $0.6 million were recorded in the Semiconductor segment and the Storage Systems segment, respectively. For a discussion of the 2009 restructuring actions, see Note 2 to the financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

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First Quarter of 2010

The $1.4 million in charges of restructuring of operations resulted from the following:

A charge of $0.9 million primarily for the change in time value of accruals for previously accrued facility lease exit costs; and

A charge of $0.5 million for severance and termination benefits for employees.

Second Quarter of 2010

The $4.9 million in charges of restructuring of operations resulted from the following:

A charge of $4.8 million for employee severance and termination benefits as we continue to streamline operations; and

A charge of $0.1 million primarily for the change in time value of accruals for previously accrued facility lease exit costs, offset by reserve reversals due to changes in estimates.

The following table summarizes the activities affecting the restructuring reserves since December 31, 2009:

	Balance at December 31, 2009	Expense During Q1 2010	Utilized During Q1 2010	Balance at April 4, 2010	Expense During Q2 2010	Utilized During Q2 2010	Balance at July 4, 2010
				(In thousands)			
Lease terminations (a)	$ 40,397	$ 846	$ (7,540)	$ 33,703	$ 106	$ (5,441)	$ 28,368
Payments to employees for severance and related benefits (b)	4,905	525	(2,919)	2,511	4,779	(1,219)	6,071
Total	$ 45,302	$ 1,371	$ (10,459)	$ 36,214	$ 4,885	$ (6,660)	$ 34,439

(a) The amount utilized represents cash payments. The balance remaining is expected to be paid during the remaining terms of the leases, which extend through 2013 and includes accruals for a licensing agreement that is no longer being used by the Company.

(b) The majority of the balance

remaining for severance is expected to be paid by the first quarter of 2011.

Note 4 Benefit Obligations

The Company has pension plans covering substantially all former Agere Systems Inc. (Agere) U.S. employees, excluding management employees hired after June 30, 2003. Retirement benefits are offered under defined benefit pension plans, which include a management plan and a represented plan, and are based on an adjusted career-average-pay, dollar-per-month formula or on a cash-balance program. The cash-balance program provides for annual company contributions based on a participant s age, compensation and interest on existing balances. It covers employees of certain companies acquired by Agere since 1996 and management employees hired after January 1, 1999 and before July 1, 2003. The Company also has a non-qualified supplemental pension plan in the U.S. that principally provides benefits based on compensation in excess of amounts that can be considered under a tax qualified plan. The Company also provides post-retirement life insurance coverage under a group life insurance plan for former Agere employees excluding participants in the cash-balance program and management employees hired after June 30, 2003. The Company also has pension plans covering certain international employees.

Effective April 6, 2009, the Company froze the U.S. defined benefit pension plans. Participants in the adjusted career-average-pay program will not earn any future service accruals after that date. Participants in the cash-balance program will not earn any future service accruals, but will continue to earn 4% interest per year on their cash-balance accounts.

The following tables summarize the components of the net periodic benefit cost/(credit):

	Three Months Ended			
	July 4, 2010		July 5, 2009	
	Pension Benefits	Post-retirement Benefits	Pension Benefits	Post-retirement Benefits
	(In thousands)			
Service cost	$ 112	$ 21	$ 486	$ 20
Interest cost	17,553	612	18,605	607
Expected return on plan assets	(17,909)	(1,150)	(19,191)	(1,219)
Amortization of prior-service cost	10		11	
Amortization of net actuarial loss/(gain) recognized	527		(24)	
Total benefit cost/(credit)	$ 293	$ (517)	$ (113)	$ (592)

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