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

FORM 10-Q

(Mark One)

REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended October 1, 2006

OR

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 LOGIC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

94-2712976
(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 No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

As of November 7, 2006, there were 400,617,350 shares of the registrant's Common Stock, \$0.01 par value, outstanding.

LSI LOGIC CORPORATION
Form 10-Q
For the Quarter Ended October 1, 2006
INDEX

	<u>Page No.</u>	
<u>PART I. FINANCIAL INFORMATION</u>		
<u>Item 1</u>	<u>Financial Statements</u>	
	<u>Consolidated Condensed Balance Sheets —as of October 1, 2006 (unaudited) and December 31, 2005</u>	3
	<u>Consolidated Condensed Statements of Operations — for the three months and the nine months ended October 1, 2006 and October 2, 2005 (unaudited)</u>	4
	<u>Consolidated Condensed Statements of Cash Flows — for the nine months ended October 1, 2006 and October 2, 2005 (unaudited)</u>	5
	<u>Notes to Unaudited Consolidated Condensed Financial Statements</u>	6
<u>Item 2</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	34
<u>Item 4</u>	<u>Controls and Procedures</u>	34
<u>PART II. OTHER INFORMATION</u>		
<u>Item 1</u>	<u>Legal Proceedings</u>	34
<u>Item 1A</u>	<u>Risk Factors</u>	34
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
<u>Item 6</u>	<u>Exhibits</u>	42
	<u>Signatures</u>	43
	<u>Index to Exhibits</u>	44
<u>EXHIBIT 10.19</u>		
<u>EXHIBIT 10.55</u>		
<u>EXHIBIT 31.1</u>		
<u>EXHIBIT 31.2</u>		
<u>EXHIBIT 32.1</u>		
<u>EXHIBIT 32.2</u>		

PART I — FINANCIAL INFORMATION**Item 1. Financial Statements**

LSI LOGIC CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	October 1, 2006	December 31, 2005
	(In thousands, except per share amounts)	
Assets		
Cash and cash equivalents	\$ 398,410	\$ 264,649
Short-term investments	869,723	674,260
Accounts receivable, less allowances of \$17,231 and \$15,328	320,251	323,310
Inventories	183,731	194,814
Prepaid expenses and other current assets	64,036	163,086
Total current assets	1,836,151	1,620,119
Property and equipment, net	83,259	98,285
Other intangibles assets, net	14,197	45,974
Goodwill	927,169	928,542
Other assets	118,134	103,146
Total assets	\$ 2,978,910	\$ 2,796,066
Liabilities and Stockholders' Equity		
Accounts payable	\$ 169,525	\$ 171,632
Accrued salaries, wages and benefits	75,660	77,713
Other accrued liabilities	135,874	140,194
Income taxes payable	89,131	79,290
Current portion of long-term debt	272,038	273,940
Total current liabilities	742,228	742,769
Long-term debt	350,000	350,000
Tax-related liabilities and other	82,470	75,110
Total long-term obligations and other liabilities	432,470	425,110
Commitments and contingencies (Note 11)	—	—
Minority interest in subsidiary	234	237
Stockholders' equity:		
Preferred shares; \$0.01 par value; 2,000 shares authorized, none outstanding	—	—
Common stock; \$0.01 par value; 1,300,000 shares authorized; 399,975 and 394,015 shares outstanding, respectively	4,000	3,940
Additional paid-in capital	3,066,158	2,996,102
Accumulated deficit	(1,279,319)	(1,389,944)
Accumulated other comprehensive income	13,139	17,852
Total stockholders' equity	1,803,978	1,627,950
Total liabilities and stockholders' equity	\$ 2,978,910	\$ 2,796,066

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

LSI LOGIC CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
	(In thousands, except per share amounts)			
Revenues	\$492,978	\$481,716	\$1,458,497	\$1,413,015
Cost of revenues	278,444	271,697	830,267	801,293
Gross profit	214,534	210,019	628,230	611,722
Research and development	102,533	101,027	305,169	301,328
Selling, general and administrative	60,276	58,966	193,790	177,875
Restructuring of operations and other items, net	2,614	99,986	(13,384)	108,675
Amortization of intangibles	6,436	15,693	28,453	50,919
Income/(loss) from operations	42,675	(65,653)	114,202	(27,075)
Interest expense	(6,556)	(6,058)	(19,314)	(19,088)
Interest income and other, net	13,066	4,567	32,912	21,500
Income/(loss) before income taxes	49,185	(67,144)	127,800	(24,663)
Provision for income taxes	5,575	6,250	17,175	18,750
Net income/(loss)	\$ 43,610	\$ (73,394)	\$ 110,625	\$ (43,413)
Net income/(loss) per share:				
Basic	\$ 0.11	\$ (0.19)	\$ 0.28	\$ (0.11)
Diluted	\$ 0.11	\$ (0.19)	\$ 0.27	\$ (0.11)
Shares used in computing per share amounts:				
Basic	399,613	391,017	397,408	389,247
Diluted	403,715	391,017	403,779	389,247

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

LSI LOGIC CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine months ended	
	October 1, 2006	October 2, 2005
	(In thousands)	
Operating activities:		
Net income/(loss)	\$ 110,625	\$ (43,413)
Adjustments:		
Depreciation and amortization	65,693	120,468
Stock-based compensation expense	36,154	3,940
Non-cash restructuring and other items	(2,576)	86,661
Gain on sale of intellectual property	(15,000)	—
Gain on sale of Gresham manufacturing facility and associated intellectual property	(12,553)	—
Write-off of intangible assets acquired in a purchase business combination	3,325	—
Non-cash foreign exchange gain	(472)	—
Gain on sale of equity securities	(1,998)	(824)
Gain on repurchase of Convertible Subordinated Notes	—	(4,123)
Gain on sale of property and equipment	(245)	(91)
Changes in deferred tax assets and liabilities	24	112
Changes in assets and liabilities:		
Accounts receivable	3,063	(26,468)
Inventories	7,158	29,767
Prepaid expenses and other assets	(13,380)	(2,090)
Accounts payable	(1,161)	6,118
Accrued and other liabilities	17,104	26,627
Net cash provided by operating activities	195,761	196,684
Investing activities:		
Purchase of debt securities available-for-sale	(498,408)	(397,240)
Proceeds from maturities and sales of debt securities available-for-sale	302,407	365,228
Purchases of equity securities	(8,150)	—
Proceeds from sales of equity securities	6,092	3,871
Purchases of property, equipment and software	(44,244)	(35,326)
Proceeds from sale of property and equipment	89	3,399
Proceeds from sale of intellectual property	22,670	—
Proceeds from sale of Fort Collins facility	10,998	—
Proceeds from sale of Colorado Springs facility	7,029	—
Proceeds from sale of Gresham manufacturing facility	96,426	—
Proceeds from sale of Gresham manufacturing facility associated intellectual property	5,100	—
Proceeds from the resolution of a pre-acquisition income tax contingency	1,373	7,662
Net cash used in investing activities	(98,618)	(52,406)
Financing activities:		
Repurchase of Convertible Subordinated Notes	—	(148,126)
Issuance of common stock	36,005	20,073
Repayment of debt obligations	—	(129)
Net cash provided by /(used in) financing activities	36,005	(128,182)
Effect of exchange rate changes on cash and cash equivalents	613	(9,165)
Increase in cash and cash equivalents	133,761	6,931
Cash and cash equivalents at beginning of period	264,649	218,723
Cash and cash equivalents at end of period	\$ 398,410	\$ 225,654

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

LSI LOGIC CORPORATION
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 — BASIS OF PRESENTATION

In the opinion of LSI Logic Corporation (the “Company” or “LSI”), the accompanying Unaudited Consolidated Condensed Financial Statements contain all adjustments (consisting only of normal recurring adjustments and restructuring and other items, net, as discussed in Note 3 to the Unaudited Consolidated Condensed Financial Statements, hereafter referred to as the “Notes”), necessary to state fairly the financial information included herein. While the Company believes that the disclosures are adequate to make the information not misleading, it is suggested that these financial statements 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, 2005.

For financial reporting purposes, the Company reports on a 13 or 14-week quarter with a year ending December 31. The current quarter ended October 1, 2006. The results of operations for the quarter ended October 1, 2006 are not necessarily indicative of the results to be expected for the full year. The first nine months of 2006 ended on October 1, 2006 and the first nine months of 2005 ended on October 2, 2005 and consisted of approximately 39 weeks each. The three months of the Company’s third quarter ended October 1, 2006 and October 2, 2005, each consisted of 13 weeks.

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 and disclosure of contingent assets and liabilities at the date of the consolidated condensed financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB interpretation No. 48 (FIN No. 48), “Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109 (FAS No. 109).” This interpretation prescribes a recognition threshold and measurement attribute for tax positions taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this interpretation is a two-step process. In the first step, recognition, the Company determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step addresses measurement of a tax position that meets the more-likely-than-not criteria. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in a) an increase in a liability for income taxes payable or a reduction of an income tax refund receivable, b) a reduction in a deferred tax asset or an increase in a deferred tax liability or c) both a and b. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be de-recognized in the first subsequent financial reporting period in which that threshold is no longer met. Use of a valuation allowance as described in FAS No. 109 is not an appropriate substitute for the de-recognition of a tax position. The requirement to assess the need for a valuation allowance for deferred tax assets based on sufficiency of future taxable income is unchanged by this interpretation. This interpretation is effective for the Company on January 1, 2007. The Company is currently evaluating the impact FIN No. 48 will have on the Company’s consolidated balance sheet and statement of operations.

In June 2006, the FASB Emerging Issues Task Force (“EITF”) issued EITF Issue No. 06-2 (EITF 06-02), “Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43 (FAS No. 43), Accounting for Compensated Absences.” EITF 06-02 addresses the accounting for an employee’s right to a compensated absence under a sabbatical or other similar benefit arrangement that is unrestricted (that is, the employee is not required to perform any services for or on behalf of the entity during the absence) and that requires the completion of a minimum service period and in which the benefit does not increase with additional years of service. For sabbatical arrangements meeting these criteria, EITF 06-02 concludes that the accumulated criteria have been met in paragraph 6(b) of FAS No. 43 and that as long as the remaining sections of paragraph 6 are met, the sabbatical arrangement should be accrued over the requisite service period, which for the Company would be 10 years. EITF 06-02 is effective for the Company on January 1, 2007 and is required to be recognized as a cumulative effect of a change in accounting principle that would need to be retroactively reflected in all prior period financial statements presented. The Company offers a

[Table of Contents](#)

sabbatical of 20 days to full-time employees upon completion of 10 years of service. The Company is currently evaluating the impact EITF 06-02 will have on the Company's consolidated balance sheet and statement of operations.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 gives guidance on how errors, built up over time in the balance sheet, should be considered from a materiality perspective and corrected. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The Company does not expect the adoption of SAB 108 to have a material impact on the Company's consolidated balance sheet or statement of operations.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. FAS 157 is effective for fiscal years beginning after November 15, 2007 and will be applied prospectively. The Company is currently evaluating the impact that the provisions of FAS 157 will have on the Company's consolidated balance sheet and statement of operations.

NOTE 2 — STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payments" (SFAS 123R), using the modified prospective transition method. In accordance with the modified prospective transition method, the Company began recognizing compensation expense for all share-based awards granted after January 1, 2006, plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made. The cumulative effect of adopting SFAS 123R was not significant.

Description of the Company's equity compensation plans:

The 2003 Equity Incentive Plan (the "2003 Plan"): The 2003 Plan was approved by stockholders in May 2003. Under the 2003 Plan, the Company may grant stock options or restricted stock units to employees, officers and consultants. Stock options will have an exercise price that is no less than the fair market value of the stock on the date of grant. The term of each option or restricted stock unit is determined by the Board of Directors or its committee and, for option grants on or after February 12, 2004, will generally be seven years. Options generally vest in annual increments of 25% per year commencing one year from the date of grant. Restricted stock units may be granted with the vesting requirements determined by the Board of Directors.

The 1991 Equity Incentive Plan (the "1991 Plan"): Under the 1991 Plan, the Company may grant stock options to employees, officers and consultants, with an exercise price that is no less than the fair market value of the stock on the date of grant. The term of each option is determined by the Board of Directors or its committee and has generally been ten years. For options granted on or after February 12, 2004, the term of the options will generally be seven years. Options generally vest in annual increments of 25% per year commencing one year from the date of grant. With respect to shares previously approved by stockholders, no incentive stock options may be granted under the 1991 plan after March 2001.

The 1995 Director Option Plan: Under the 1995 Director Option Plan, new directors receive an initial grant of option to purchase 30,000 shares of common stock and directors receive subsequent automatic grants of 30,000 options to purchase shares of common stock each year thereafter. The initial grants vest in annual increments of 25% per year, commencing one year from the date of grant. Subsequent option grants become exercisable in full six months after the grant date. The term of each option is ten years. The exercise price of the options granted is equal to the fair market value of the stock on the date of grant.

The 1999 Nonstatutory Stock Option Plan (the "1999 Plan"): Under the 1999 Plan, the Company may grant nonstatutory stock options to its employees, excluding officers, with an exercise price that is no less than the fair market value of the stock on the date of grant. The term of each option is determined by the Board of Directors or its committee and has generally been ten years. For options granted on or after February 12, 2004, the term of the options will be seven years. Options generally vest in annual increments of 25% per year commencing one year from the date of grant.

The Employee Stock Purchase Plan, as amended and restated ("US ESPP"): Under the US ESPP, rights are granted to LSI Logic employees in the United States to purchase shares of common stock at 85% of the lesser of the fair market value of such shares

[Table of Contents](#)

at the beginning of a 12-month offering period or the end of each six-month purchase period within such an offering period. There are 18,187,817 shares remaining available for future issuance under this plan. The US ESPP includes an annual replenishment calculated at 1.2% of the Company's common stock issued and outstanding at the fiscal year end less the number of shares available for future grants under the US ESPP. No shares have been added to the US ESPP from the annual replenishment since January 2001.

International Employee Stock Purchase Plan ("IESPP"): Under the IESPP, rights are granted to LSI Logic employees (excluding executive officers) outside of the United States to purchase shares of common stock at 85% of the lesser of the fair market value of such shares at the beginning of a 12-month offering period or the end of each six-month purchase period within such an offering period. There are 1,944,748 shares remaining available for future issuance under the IESPP.

Stock-based compensation expense under SFAS 123R:

Stock-based compensation expense under SFAS 123R in the consolidated condensed statements of operations for the three and nine months ended October 1, 2006 was \$11.0 million and \$36.2 million, respectively, as shown in the table below. Stock-based compensation costs capitalized to inventory and software for the three and nine months ended October 1, 2006 were not significant.

The estimated fair value of the Company's stock-based awards, less expected forfeitures, is amortized over each award vesting period (the requisite service period), on a straight-line basis. The table below summarizes stock-based compensation expense, related to employee stock options, the stock purchase plans and restricted stock units under SFAS 123R for the three and nine months ended October 1, 2006.

Prior to January 1, 2006, the Company accounted for stock-based compensation awards using the intrinsic value method under APB 25, "Accounting for Stock Issued to Employees," and related interpretations and followed the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended. Such disclosure-only provisions are also referred to herein as pro forma financial information. Under APB 25 and related interpretations, compensation costs for stock options, if any, was measured as the excess of the quoted market price on the date of grant over the exercise price and recognized over the vesting period on a straight-line basis. The Company's policy is to grant options with an exercise price no less than the quoted closing market price of the Company's stock on the date of grant. For a complete discussion of stock-based compensation prior to January 1, 2006, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

<u>Stock-based compensation expense:</u>	<u>Three months ended</u>		<u>Nine months ended</u>	
	<u>October 1, 2006</u>	<u>October 2, 2005</u>	<u>October 1, 2006</u>	<u>October 2, 2005</u>
	(In thousands)			
Cost of revenues	\$ 1,719	\$ 186	\$ 5,702	\$ 511
Research and development	3,908	503	13,073	1,908
Selling, general and administrative	5,398	624	17,379	1,521
Total stock-based compensation expense	<u>\$ 11,025</u>	<u>\$ 1,313</u>	<u>\$ 36,154</u>	<u>\$ 3,940</u>

[Table of Contents](#)

Stock Options

The fair value of each option grant is estimated on the date of grant using a reduced form calibrated binomial lattice model (the "Lattice Model"). This model requires the use of historical data for employee exercise behavior and the use of assumptions outlined in the following table:

Employee Stock Options Granted	Three months ended October 1, 2006	Nine months ended October 1, 2006
Weighted average estimated grant date fair value	\$2.97	\$3.30
Weighted average assumptions in calculation:		
Expected life (years)	4.36	4.32
Risk-free interest rate	5%	5%
Volatility	48%	48%
Dividend yield	—	—

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the Lattice Model. The expected life of employee stock options is affected by all of the underlying assumptions and calibration of the Company's model.

The Company used an equally weighted combination of historical and implied volatilities as of the grant date. The historical volatility is the standard deviation of the daily stock returns for LSI from the date of the Company's initial public offering in 1983. The Company used implied volatilities of near-the-money LSI traded call options, as stock options are call options that are granted at the money. The historical and implied volatilities were annualized and equally weighted to determine the volatilities as of the grant date. Prior to January 1, 2006, the Company used historical implied stock price volatilities in accordance with SFAS 123 for purposes of its pro forma information. Company management believes that the equally weighted combination of historical and implied volatilities is more representative of future stock price trends than sole use of historical implied volatilities.

The risk-free interest rate assumption is based upon observed interest rates of constant maturity treasuries appropriate for the term of the Company's employee stock options.

The Lattice Model assumes that employees' exercise behavior is a function of the option's remaining vested life and the extent to which the option is in-the-money. The Lattice Model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations on all past option grants made by the Company since the initial public offering in 1983.

As stock-based compensation expense recognized in the consolidated condensed statement of operations for the three and nine months ended October 1, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience. For the Company's pro forma information required under SFAS 123 for the periods prior to January 1, 2006, the Company accounted for forfeitures as they occurred.

Table of Contents

A summary of the changes in stock options outstanding under the Company's equity-based compensation plans during the nine months ended October 1, 2006 is presented below (share amounts in thousands):

	Number of Shares (In thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (In years)	Average Intrinsic Value (In thousands)
Options outstanding at January 1, 2006	70,618	\$ 13.21	—	\$ —
Options granted	7,069	9.16	—	—
Options exercised	(3,542)	(6.62)	—	—
Options canceled	(11,040)	(16.02)	—	—
Options outstanding at October 1, 2006	63,105	\$ 12.63	4.84	\$44,300
Options exercisable at October 1, 2006	41,208	\$ 15.15	4.21	\$24,448

During the second quarter of 2005, Abhijit Y. Talwalkar, joined the company as President and Chief Executive Officer. As part of his initial stock option grants, Mr. Talwalkar was granted non-statutory stock options to purchase 2,000,000 shares of Company common stock under the 2003 Equity Incentive Plan at an exercise price equal to the closing price per share on the New York Stock Exchange ("NYSE") for the common stock of the Company on the date of grant. The shares subject to such option will vest based on Mr. Talwalkar attaining certain performance criteria determined by the Compensation Committee of the Board of Directors. The shares subject to such option are scheduled to fully vest six years after the date of grant, whether or not the performance goals are met, subject to Mr. Talwalkar's continued employment with the Company on each scheduled vesting date.

As of October 1, 2006, total unrecognized compensation expense related to nonvested stock options, net of estimated forfeitures, was approximately \$76.2 million and is expected to be recognized over the next 2.8 years on a weighted average basis. The total intrinsic value of options exercised during the three and nine months ended October 1, 2006 was \$1.8 million and \$11.5 million, respectively. Cash received from stock option exercises was \$3.8 million and \$23.4 million during the three and nine months ended October 1, 2006, respectively.

The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well a number of highly complex and subjective assumptions. The Company uses third-party consultants to assist in developing the assumptions used in as well as calibrating the Lattice Model. The Company is responsible for determining the assumptions used in estimating the fair value of its share-based payment awards.

Employee Stock Purchase Plans

The Company also has two employee stock purchase plans ("ESPPs" — US ESPP and IESPP) under which rights are granted to all qualifying employees to purchase shares of common stock at 85% of the lesser of the fair market value of such shares at the beginning of a 12-month offering period or the end of each six-month purchase period within such an offering period, typically in May and November. Compensation expense is calculated using the fair value of the employees' purchase rights under the Black-Scholes model. A total of 1.9 million shares related to the ESPPs were issued during the three months ended July 2, 2006. No shares related to the ESPPs were issued during the three months ended October 1, 2006. There were approximately 20.1 million shares of common stock reserved for issuance under the ESPPs as of October 1, 2006. The stock-based compensation expense for the three months ended October 1, 2006 stemming from the May 14, 2006 ESPP grants was not significant because the majority of employees of the Company enrolled in the 12-month purchase period in November 2005 and cannot re-enroll until November 2006. For disclosure purposes, we have included the assumptions that went into the calculation of fair value for May 2006 grant as follows:

Employee Stock Purchase Plans Granted	Three months ended July 2, 2006
Weighted average estimated grant date fair value	\$3.05
Weighted average assumptions in calculation:	
Expected life (years)	0.8
Risk-free interest rate	5%
Volatility	39%
Dividend yield	—

Restricted Stock Awards

Under the 2003 Equity Incentive Plan ("2003 Plan"), the Company may grant restricted stock awards. No participant may be granted more than 0.5 million shares of restricted stock in any year. The vesting requirements for the restricted stock awards are

[Table of Contents](#)

determined by the Board of Directors. Typically, vesting of restricted stock awards is subject to the employee's continuing service to the Company. The cost of these awards is determined using the fair value of the Company's common stock on the date of grant and compensation expense is recognized over the vesting period on a straight-line basis.

A summary of the changes in restricted stock awards outstanding during the nine months ended October 1, 2006 is presented below:

	Number of shares (In thousands)
Non-vested shares at January 1, 2006	2,375
Granted	498
Vested	(850)
Forfeited	(223)
Non-vested shares at October 1, 2006	<u>1,800</u>

As of October 1, 2006, the Company had approximately \$10.2 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock awards, which will be recognized over the weighted average period of 2.2 years. The fair value of shares vested during the three and nine months ended October 1, 2006 was \$0.7 million and \$7.5 million, respectively.

There are a total of approximately 120 million shares of common stock reserved for issuance upon exercise of options and vesting of restricted stock awards, including options available for future grants, outstanding under all stock option plans.

Income taxes

In November 2005, the FASB issued FASB Staff Position No. FAS 123R-3 "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." The Company has one year from the date of adoption to elect the transition method. Until such election is made, the "Long-Form" transition method must be used. In addition, in accordance with SFAS 123R, SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"), and EITF Topic D-32, "Intraperiod Tax Allocation of the Effect of Pretax Income from Continuing Operations," the Company has elected to recognize excess income tax benefits from stock option exercises in additional paid-in capital only if an incremental income tax benefit would be realized after considering all other tax attributes presently available to the Company.

The Company records its stock-based compensation expense in multiple jurisdictions. In jurisdictions where an income tax deduction is allowed and an income tax benefit is realizable, the Company has recognized an income tax benefit. In jurisdictions where an income tax deduction is not allowed or where an income tax benefit is not realizable, an income tax benefit has not been recognized.

Earnings per share

Basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common shares outstanding and dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of employee stock options and restricted common stock. Under the treasury stock method, the amount the employee must pay for exercising stock options, employee stock purchase rights, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase the shares.

Pro Forma Information under SFAS 123 for Period Prior to January 1, 2006 :

Prior to January 1, 2006, the Company followed the disclosure-only provisions of SFAS 123. The following table provides pro forma disclosures as if the Company had recorded compensation costs based on the estimated grant date fair value, as defined by the SFAS 123, for awards granted under its stock-based compensation plans. In such case, the Company's net income per share would have been adjusted to the pro forma amounts below.

[Table of Contents](#)

	Three months ended October 2, 2005	Nine months ended October 2, 2005
	(In thousands, except per share amounts)	
Net loss, as reported	\$(73,394)	\$ (43,413)
Add: Amortization of non-cash deferred stock compensation determined under the intrinsic value method as reported in net income, net of related tax effects *	44	340
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects*	(17,362)	(60,876)
Pro forma net loss	<u>\$(90,712)</u>	<u>\$(103,949)</u>
Loss per share:		
Basic-as reported	\$ (0.19)	\$ (0.11)
Basic-pro forma	\$ (0.23)	\$ (0.27)
Diluted-as reported	\$ (0.19)	\$ (0.11)
Diluted-pro forma	\$ (0.23)	\$ (0.27)

* This amount excludes amortization of stock-based compensation on restricted stock awards.

The stock-based compensation expense determined under the fair value method, included in the table above, was calculated using the Black-Scholes model. The Black-Scholes model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. This model also requires highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated grant date fair value. The following weighted average assumptions were used in determining the estimated grant date fair values:

<u>Employee Stock Options Granted</u>	<u>Three months ended October 2, 2005</u>	<u>Nine months ended October 2, 2005</u>
Weighted average estimated grant date fair value	\$5.77	\$4.62
Assumptions in calculation:		
Expected life (years)	4.42	4.50
Risk-free interest rate	4%	4%
Volatility	78%	79%
Dividend yield	—	—

NOTE 3— RESTRUCTURING AND OTHER ITEMS

The Company recorded a charge of \$2.6 million and a net credit of \$13.4 million in restructuring of operations and other items for the three and nine months ended October 1, 2006, respectively. A charge of \$2.7 million and a credit of \$14.6 million was recorded in the Semiconductor segment and a credit of \$0.1 million and a charge of \$1.2 million was recorded in the Storage Systems segment for the three and nine months ended October 1, 2006, respectively. The Company recorded charges of \$100.0 million and \$108.7 million in restructuring of operations and other items for the three and nine months ended October 2, 2005, respectively, primarily in the Semiconductor segment. For a complete discussion of the 2005 restructuring actions, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Restructuring and impairment of long-lived assets:

First quarter of 2006:

The \$5.7 million charge in the first quarter of 2006 is related to the net effect of the following items. An expense of \$2.7 million was recorded for changes in sublease assumptions for certain previously accrued facility lease termination costs. An expense of \$0.5

Table of Contents

million was recorded to reflect the change-in-time value of accruals for facility lease termination costs. An expense of \$5.7 million was recorded for severance and termination benefits for employees primarily related to the broad-based reorganization that was announced in August 2005. Other exit costs of \$1.4 million include contract termination costs of \$0.9 million related to the Company's strategic realignment of the sales function and an expense of \$0.5 million for facility closure costs related to the Colorado fabrication facility as the expenses were incurred. Net gains of \$4.6 million were recorded to reflect a) the increase in fair value for our Colorado Springs facility that was sold to a third party subsequent to the first quarter of 2006, b) a gain for the sale of certain intellectual property to a third party during the first quarter of 2006 that was written down to zero due to impairment in a previous year and c) the write-down of certain equipment held for sale to fair market value.

Second quarter of 2006:

The \$21.6 million credit is related to the net effect of the following items:

- \$12.5 million net gain recorded for the sale of Gresham, Oregon manufacturing facility and certain related manufacturing process intellectual property to ON Semiconductor;
- \$15.0 million gain recorded for the sale of certain intellectual property to a third party based on the sale of zero basis intellectual property for \$15.0 million in cash proceeds;
- \$7.4 million gain recorded for the sale of the Company's ZSP digital signal processor intellectual technology;
- \$8.6 million charge recorded for severance and termination benefits for employees primarily related to the broad-based reorganization that was announced in August 2005;
- \$3.3 million charge recorded for the write-off of certain intangible assets acquired in a purchase business combination; and
- \$1.4 million net charge recorded primarily for changes in sublease assumptions for certain previously accrued facility lease termination costs.

Sale of the Gresham facility:

In May 2006, the Company completed the sale of our Gresham, Oregon manufacturing facility to ON Semiconductor for approximately \$105.0 million in cash. \$90 million in cash was received in the second quarter of 2006 and \$15.0 million was received early in the third quarter of 2006. Under the terms of the agreement, ON Semiconductor offered employment to substantially all of the LSI manufacturing employees based at the Gresham site, with the remaining non-manufacturing workforce expected to continue their employment with LSI. ON Semiconductor also entered into additional agreements with LSI, including a multi-year wafer supply and test agreement, intellectual property license agreement, transition services agreement and a facilities use agreement.

The Company recognized a gain of \$12.5 million associated with the sale of the Gresham manufacturing facility. No amounts were deferred pursuant to the transaction as any continuing involvement with the Gresham manufacturing facility does not carry with it the same risks and rewards as does ownership of the property, nor would any portion of the sales price need to be deferred due to the nature and fair market value pricing of the ancillary agreements entered into as discussed below as they represent separate earnings processes.

Under the terms of the wafer supply agreement, LSI is a customer of ON Semiconductor, whereby LSI has agreed to purchase \$198.8 million in wafers from ON Semiconductor during the period from the date of sale of the Gresham facility in May 2006 to the end of LSI's second quarter of 2008. Such wafer supply agreements are customary with the sale of large wafer manufacturing facilities and the wafer prices under the agreement represent fair market values. The wafers purchased from ON Semiconductor will be recognized by LSI as purchases of inventory upon transfer of title of the inventory to LSI from ON Semiconductor. Deliverables under the intellectual property license agreement were completed upon sale of the facility to ON Semiconductor in May 2006. The transition services agreement was short-term in nature and priced separately from the overall sale agreement. Services performed by LSI under this agreement were primarily related to short-term accounting systems services and priced at fair market value. The facility use agreement is for a term of 36 months whereby LSI leases space from ON Semiconductor. LSI pays ON Semiconductor fair market value for such space rental.

Third quarter of 2006:

The \$2.6 million charge is related to the net effect of the following items:

- \$1.7 million charge recorded for severance and termination benefits for employees primarily related to the broad-based reorganization that was announced in August 2005;

Table of Contents

- \$0.4 million net charge recorded primarily for changes in sublease assumptions for certain previously accrued facility lease termination costs and additional \$0.4 million recorded to reflect the change-in-time value of accruals for facility lease termination costs; and
- \$0.1 million net charge recorded for other exit costs, mainly related to the contract termination costs related to the Company's strategic realignment of the sales function.

Assets held for sale of \$20.1 million and \$105.8 million were included as a component of prepaid expenses and other current assets as of October 1, 2006 and December 31, 2005, respectively. During the three months ended July 2, 2006, we sold the Gresham, Oregon manufacturing facility and two Colorado facilities. The gain from the Gresham facility is described above. The net loss from the sale of the two Colorado facilities was insignificant. Assets classified as held-for-sale are not depreciated. The fair values of impaired equipment and facilities were thoroughly researched and estimated by management using the assistance of third-party appraisers. Given that current market conditions for the sale of older fabrication facilities and related equipment may fluctuate, there can be no assurance that the Company will realize the current net carrying value of the assets held for sale. The Company reassesses the realizability of the carrying value of these assets at the end of each quarter until the assets are sold or otherwise disposed of and additional adjustments may be necessary.

The following table sets forth the Company's restructuring reserves as of October 1, 2006, which are included in other accrued liabilities on the balance sheet:

(In thousands)	Balance at December 31, 2005	Restructuring Expense Q1, 2006	Utilized during Q1, 2006	Balance at April 2, 2006	Restructuring Expense Q2, 2006	Utilized during Q2, 2006	Balance at July 2, 2006	Restructuring Expense Q3, 2006	Utilized during Q3, 2006	Balance at October 1, 2006
Write-down of excess assets and decommissioning costs (a)	\$ 4,993	\$ —	\$ (48)	\$ 4,945	\$ —	\$ (4,565)	\$ 380	\$ (30)	\$ (350)	\$ —
Lease terminations (b)	22,287	3,144	(2,220)	23,211	1,627	(1,684)	23,154	824	(1,213)	22,765
Facility closure and other exit costs (c)	—	1,368	(463)	905	20	(612)	313	105	(418)	—
Payments to employees for severance (d)	5,395	5,693	(1,743)	9,345	8,552	(3,295)	14,602	1,715	(15,544)	773
Total	\$ 32,675	\$ 10,205	\$ (4,474)	\$ 38,406	\$ 10,199	\$ (10,156)	\$ 38,449	\$ 2,614	\$ (17,525)	\$ 23,538

- (a) The remaining balance was utilized during the third quarter of 2006.
- (b) Amounts utilized represent cash payments. The balance remaining for real estate lease terminations will be paid during the remaining terms of these contracts, which extend through 2011.
- (c) Amounts utilized represent cash payments.

[Table of Contents](#)

- (d) Amounts utilized represent a) cash severance payments to 118 employees during the nine months ended October 1, 2006 and b) cash payments for one-time termination benefits for 512 employees associated with the sale of the Gresham manufacturing facility.

NOTE 4 —INVESTMENTS

	October 1, 2006	December 31, 2005
	(In thousands)	
Available-for-sale debt securities		
Asset and mortgage-backed securities	\$361,417	\$335,495
U.S. government and agency securities	323,984	266,077
Corporate and municipal debt securities	184,322	72,688
Total short-term investments	<u>\$869,723</u>	<u>\$674,260</u>
Long-term investments in equity securities		
Marketable equity securities available-for-sale	\$ 7,814	\$ 18,769
Non-marketable equity securities	12,973	7,070
Total long-term investments in equity securities	<u>\$ 20,787</u>	<u>\$ 25,839</u>

Accumulated other comprehensive income included unrealized losses/(gains) on investments in available-for-sale debt and equity securities of \$0.5 million, net of the related tax effect of \$0.2 million, and \$(4.4) million, net of the related tax effect of \$(2.4) million, as of October 1, 2006, and December 31, 2005, respectively.

Net realized losses on sales of investments in available-for-sale debt securities were \$0.3 million and \$1.2 million for the three and nine months ended October 1, 2006, respectively. Net realized losses on sales of investments in available-for-sale debt securities were \$ 0.2 million and \$1.0 million for the three and nine months ended October 2, 2005, respectively.

The Company realized a pre-tax gain of \$2.0 million for certain marketable available-for-sale equity securities as follows for the nine months ended October 1, 2006:

- A \$0.8 million pre-tax gain related to the sale of certain marketable available-for-sale equity securities for the three months ended October 1, 2006;
- A \$1.4 million pre-tax gain related to the sale of certain marketable available-for-sale equity securities for the three months ended April 2, 2006; and
- A \$0.2 million pre-tax loss related to the sale of certain marketable available-for-sale equity securities of a certain technology company that was acquired by another technology company for the three months ended July 2, 2006.

The Company realized pre-tax gains of \$2.4 million related to the following for the nine months ended October 2, 2005:

- A \$1.0 million pre-tax gain related to the sale of certain marketable available-for-sale equity securities for the three months ended July 3, 2005; and
- A \$1.4 million pre-tax gain associated with marketable available-for-sale equity securities of a certain technology company that was acquired by another technology company for the three months ended July 3, 2005.

[Table of Contents](#)

The following table includes the details of pre-tax losses related to investments in equity securities that the Company has recorded during the nine months ended October 1, 2006 and October 2, 2005, respectively. Management believes that the declines in value were other than temporary.

	Non-marketable equity investments	Marketable equity investments
	(in millions)	
Pre-tax loss:		
Three months ended October 1, 2006	\$ —	\$—
Nine months ended October 1, 2006	—	—
Pre-tax loss:		
Three months ended October 2, 2005	\$1.5	\$—
Nine months ended October 2, 2005	1.5	—
Total carrying value of impaired investments as of October 1, 2006	\$ —	\$—

In November 2005, FASB issued FSP FAS 115-1/FAS 124-1, “The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments” (“FSP 115-1/124-1”). FSP 115-1/124-1 provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1/124-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1/124-1 is required to be applied to reporting periods beginning after December 15, 2005. FSP 115-1/124-1 did not have a material impact on the Company’s consolidated balance sheet or statement of operations.

NOTE 5 — BALANCE SHEET DETAIL

	October 1, 2006	December 31, 2005
	(In thousands)	
Cash and cash equivalents:		
Cash in financial institutions	\$ 34,916	\$ 85,641
Cash equivalents	363,494	179,008
	<u>\$398,410</u>	<u>\$264,649</u>
Inventories:		
Raw materials	\$ 35,263	\$ 30,541
Work-in-process	49,887	62,167
Finished goods	98,581	102,106
	<u>\$183,731</u>	<u>\$194,814</u>

In November 2004, the FASB issued SFAS No. 151, “Inventory Costs—an amendment of ARB No. 43, chapter 4.” This statement clarifies the accounting for abnormal amounts of facility expense, freight, handling costs and wasted materials (spoilage) to require them to be recognized as current-period charges. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of this standard did not have a material impact on the Company’s consolidated balance sheet or statement of operations.

NOTE 6 — DEBT

	<u>Maturity</u>	<u>Interest Rate</u>	<u>Conversion Price</u>	<u>October 1, 2006</u>	<u>December 31, 2005</u>
			(In thousands)		
2003 Convertible Subordinated Notes	May 2010	4%	\$13.4200	\$ 350,000	\$ 350,000
2001 Convertible Subordinated Notes	November 2006	4%	\$26.3390	271,848	271,848
Deferred gain on terminated swaps				190	2,092
				622,038	623,940
Current portion of long-term debt				(272,038)	(273,940)
Long-term debt				\$ 350,000	\$ 350,000

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full.

NOTE 7— RECONCILIATION OF BASIC AND DILUTED INCOME/(LOSS) PER SHARE

	<u>Three months ended</u>					
	<u>October 1, 2006</u>			<u>October 2, 2005</u>		
	<u>Income*</u>	<u>Shares+</u>	<u>Per-Share Amount</u>	<u>(Loss)*</u>	<u>Shares+</u>	<u>Per-Share Amount</u>
			(In thousands except per share amounts)			
Basic EPS:						
Net income/(loss) available to common stockholders	\$43,610	399,613	\$0.11	\$(73,394)	391,017	\$(0.19)
Stock options, employee stock purchase rights and restricted stock awards	—	4,102	—	—	—	—

Diluted EPS:						
Net income/(loss) available to common stockholders	\$43,610	403,715	\$0.11	\$(73,394)	391,017	\$(0.19)

	<u>Nine months ended</u>					
	<u>October 1, 2006</u>			<u>October 2, 2005</u>		
	<u>Income*</u>	<u>Shares+</u>	<u>Per-Share Amount</u>	<u>(Loss)*</u>	<u>Shares+</u>	<u>Per-Share Amount</u>
			(In thousands except per share amounts)			
Basic EPS:						
Net income/(loss) available to common stockholders	\$110,625	397,408	\$0.28	\$(43,413)	389,247	\$(0.11)
Stock options, employee stock purchase rights and restricted stock awards	—	6,371	—	—	—	—

Diluted EPS:						
Net income/(loss) available to common stockholders	\$110,625	403,779	\$0.27	\$(43,413)	389,247	\$(0.11)

* Numerator

+ Denominator

Options to purchase 53,440,330 and 46,338,673 shares outstanding during the three and nine months ended October 1, 2006, respectively, were excluded from the computation of diluted shares because of their antidilutive effect on net income per share. Options to purchase 71,792,901 and shares outstanding during the three and nine months ended October 2, 2005, were excluded from the computation of diluted shares because of their antidilutive effect on net loss per share.

For the three and nine months ended October 1, 2006, weighted average potentially dilutive shares of 36,401,581 associated with the 2003 and 2001 Convertible Notes were excluded from the calculation of diluted shares because of their antidilutive effect on net income per share. For the three and nine months ended October 2, 2005, weighted average potentially dilutive shares of 36,401,581 and 39,069,163 associated with the 2003 and 2001 Convertible Notes were excluded from the calculation of diluted shares because of their antidilutive effect on net loss per share.

NOTE 8 — COMPREHENSIVE INCOME/ (LOSS)

Comprehensive income/(loss) is defined as a change in equity of a company during a period from transactions and other events and circumstances, excluding transactions resulting from investments by owners and distributions to owners. Comprehensive income/(loss), net of taxes for the current reporting period and comparable period in the prior year is as follows:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
	(In thousands)			
Net income/(loss)	\$43,610	\$(73,394)	\$110,625	\$(43,413)
Change in unrealized gain/(loss) on derivative instruments designated as and qualifying as cash-flow hedges	—	260	—	(275)
Change in unrealized gain/(loss) on available-for-sale securities	3,867	2,422	(4,893)	(1,851)
Change in foreign currency translation adjustments	(916)	(2,546)	180	(9,336)
Comprehensive income/(loss)	\$46,561	\$(73,258)	\$105,912	\$(54,875)

NOTE 9 — SEGMENT REPORTING

The Company operates in two reportable segments — the Semiconductor segment and the Storage Systems segment — in which the Company offers products and services for a variety of electronic systems applications. LSI's products are marketed primarily to original equipment manufacturers ("OEMs") that sell products to the Company's target markets. The information provided herein has been recast to include the RAID Storage Adapter ("RSA") business as part of the Storage Systems segment from the Semiconductor segment for all periods presented.

The following is a summary of operations by segment for the three and nine months ended October 1, 2006 and October 2, 2005:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
	(In thousands)			
Revenues:				
Semiconductor	\$313,273	\$311,739	\$ 919,038	\$ 940,940
Storage Systems	179,705	169,977	539,459	472,075
Total	\$492,978	\$481,716	\$1,458,497	\$1,413,015
Income/(loss) from operations:				
Semiconductor	\$ 26,276	\$ (75,641)	\$ 72,177	\$ (37,188)
Storage Systems	16,399	9,988	42,025	10,113
Total	\$ 42,675	\$ (65,653)	\$ 114,202	\$ (27,075)

Intersegment revenues for the periods presented above were not significant. For the three months ended October 1, 2006, restructuring of operations and other items, a net of \$2.6 million, was primarily included in the Semiconductor segment. For the nine months ended October 1, 2006, restructuring of operations and other items for the Semiconductor and Storage Systems segments were a net credit of \$14.6 million and a charge of \$1.2 million, respectively. For the three and nine months ended October 2, 2005, restructuring of operations and other items, net of \$100.0 million and \$108.7 million, respectively, were primarily included in the Semiconductor segment.

[Table of Contents](#)

Significant Customers. The following table summarizes the number of our significant customers, each of whom accounted for 10.0% or more of the Company's revenues, along with the percentage of revenues they individually represent on a consolidated basis and by segment:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Semiconductor segment:				
Number of significant customers	1	2	1	1
Percentage of segment revenues	19%	16%,12%	19%	17%
Storage Systems segment:				
Number of significant customers	3	2	2	3
Percentage of segment revenues	45%,15%,10%	46%,11%	45%,15%	43%,13%,10%
Consolidated:				
Number of significant customers	2	2	2	2
Percentage of consolidated revenues	17%,12%	17%,11%	18%,12%	15%,11%

The following is a summary of total assets by segment as of October 1, 2006 and December 31, 2005:

	October 1, 2006	December 31, 2005
	(In thousands)	
Total assets:		
Semiconductor	\$2,447,153	\$2,285,913
Storage Systems	531,757	510,153
Total	\$2,978,910	\$2,796,066

Revenues from domestic operations were \$219.9 million, representing 44.6% of consolidated revenues for the three months ended October 1, 2006 compared to \$230.8 million, representing 47.9% of consolidated revenues for the three months ended October 2, 2005.

Revenues from domestic operations were \$692.4 million, representing 47.5% of consolidated revenues for the nine months ended October 1, 2006 compared to \$666.4 million, representing 47.2% of consolidated revenues for the nine months ended October 2, 2005.

NOTE 10— RELATED PARTY TRANSACTIONS

A member of our Board of Directors is also a member of the Board of Directors of Seagate Technology. The Company sells semiconductors used in storage product applications to Seagate Technology for prices an unrelated third party would pay for such products. Revenues associated with product sales to Seagate Technology were \$59.8 million and \$175.5 million for the three months and the nine months ended October 1, 2006, respectively. Revenues associated with product sales to Seagate Technology were \$51.2 million and \$156.5 million for the three and nine months ended October 2, 2005, respectively. The Company had accounts receivable due from Seagate Technology of \$46.8 million and \$41.2 million as of October 1, 2006 and December 31, 2005, respectively.

NOTE 11 — COMMITMENTS, CONTINGENCIES AND LEGAL MATTERS

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, validity of certain intellectual property rights, non-infringement of third-party rights, and certain income tax-related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to and cooperating with the Company pursuant to the procedures specified in the particular contract. This usually allows the Company to challenge the other party's claims or, in case of breach of intellectual property

Table of Contents

representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company's obligations under these agreements may be limited in terms of activity (typically to replace or correct the products or terminate agreement with a refund to the other party), duration and/or amounts. In some instances, the Company may have recourse against third parties and/or insurance covering certain payments made by the Company.

In February 1999, a lawsuit alleging patent infringement was filed in the United States District Court for the District of Arizona by the Lemelson Medical, Education & Research Foundation, Limited Partnership ("Lemelson") against 88 electronics industry companies, including LSI. The case number is CIV990377PHXRGs. The patents involved in this lawsuit are alleged to relate to semiconductor manufacturing and computer imaging, including the use of bar coding for automatic identification of articles. The plaintiff has sought a judgment of infringement, an injunction, treble damages, attorneys' fees and further relief as the court may provide. In September 1999, the Company filed an answer denying infringement and raising affirmative defenses. In addition, the Company asserted a counterclaim for declaratory judgment of non-infringement, invalidity and unenforceability of Lemelson's patents. In December 2005, Lemelson filed a motion asking the Court to dismiss, with prejudice, all claims related to the 14 computer imaging patents. LSI did not oppose the motion and the Court has dismissed those patents, with prejudice. In October 2005, the court issued a preliminary ruling on the claim construction of the four remaining patents, following a hearing in December 2004. At the court's request, the parties have submitted objections to the preliminary ruling. A final ruling on the claim construction was issued on August 8, 2006. On October 13, 2006, the court denied Lemelson's request for reconsideration of the August 2006 ruling. No trial date has been set. While the Company can give no assurances regarding the final outcome of this lawsuit, the Company believes the allegations made by Lemelson are without merit and is defending the action vigorously.

The Company and its subsidiaries are parties to other litigation matters and claims that are normal in the course of its operations. The Company aggressively defends all legal matters and does not believe, based on currently available facts and circumstances, that the final outcome of these matters, taken individually or as a whole, will have a material adverse effect on the Company's consolidated results of operations and financial condition. However, the pending unsettled lawsuits may involve complex questions of fact and law and will likely require the expenditure of significant funds and the diversion of other resources to defend. From time to time, the Company may enter into confidential discussions regarding the potential settlement of such lawsuits; however, there can be no assurance that any such discussions will occur or will result in a settlement. Moreover, the settlement of any pending litigation could require the Company to incur substantial costs and, in the case of the settlement of any intellectual property proceeding against the Company, may require the Company to obtain a license under a third party's intellectual property rights that could require royalty payments in the future and the Company to grant a license to certain of its intellectual property rights to a third party under a cross-license agreement. The results of litigation are inherently uncertain, and material adverse outcomes are possible.

NOTE 12— SUBSEQUENT EVENTS

On October 25, 2006, the Company announced that it entered into a definitive agreement to acquire StoreAge Networking Technologies Ltd. ("StoreAge") for approximately \$50 million in cash. StoreAge, a privately held company based in Neshar, Israel with US offices in Irvine, California, provides SAN storage management and multi-tiered, data protection software for the enterprise. Under terms of the agreement, the Company will acquire all outstanding StoreAge capital stock. Additionally, the Company anticipates offering employment to all StoreAge employees, who are expected to join the company's Engenio Storage Group upon closing. The transaction is expected to close in the fourth quarter of 2006 and is subject to satisfaction of customary closing conditions.

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q contains forward-looking statements. In many cases you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "intend" or "continue," or the negative of such terms and other comparable terminology. In addition, forward-looking statements in this document include, but are not limited to, the following: projected revenues for the three months ending December 31, 2006, projections of gross profit margins for the three months ending December 31, 2006 and projected capital expenditures in 2006. We assume no obligation to update any such forward-looking statements, and these statements involve risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. For a summary of such risks and uncertainties, please see the paragraphs located in Part II, Item 1A entitled "Risk Factors" in Part II and please also see the Risk Factors located in our Annual Report on Form 10-K for the year ended December 31, 2005.

OVERVIEW

We are a leading provider of silicon-to-system solutions that are used at the core of products that create, store and consume digital information. We offer a broad portfolio of capabilities including custom and standard product integrated circuits, host bus and RAID adapters, storage area network solutions and software applications. Our products enable leading technology companies in the storage and consumer markets to deliver some of the most advanced and well-known electronic systems in the market today.

We operate in two segments — the Semiconductor segment and the Storage Systems segment — in which we offer products and services for a variety of electronic systems applications. Our products are marketed primarily to original equipment manufacturers ("OEMs") that sell products to our target markets. The information provided herein has been reclassified to include the RAID Storage Adapter ("RSA") business as part of the Storage Systems segment from the Semiconductor segment for all periods presented.

Revenues for the three months ended October 1, 2006 were \$493.0 million representing a 2.3% increase from \$481.7 million in revenues for the three months ended October 2, 2005. Revenues for the nine months ended October 1, 2006 were \$1,458.5 million representing a 3.2% increase from \$1,413.0 million in revenues for the nine months ended October 2, 2005. The increases in 2006 as compared to the prior year periods are attributable to higher revenues in the Storage Systems segment, offset in part by a decline in revenues for the Semiconductor segment.

We reported net income of \$43.6 million or \$0.11 a diluted share for the three months ended October 1, 2006 as compared to a net loss of \$73.4 million or \$0.19 a diluted share for the three months ended October 2, 2005. We reported net income of \$110.6 million or \$0.27 a diluted share for the nine months ended October 1, 2006 as compared to net loss of \$43.4 million or \$0.11 a diluted share for the nine months ended October 2, 2005.

For the three months ending December 31, 2006, we expect our consolidated revenues to be in the range of \$500.0 million to \$525.0 million.

We expect our overall consolidated gross profit margins to be in the 43% to 44% range for the three months ending December 31, 2006.

Cash, cash equivalents and short-term investments were \$1.3 billion as of October 1, 2006 as compared to \$1.2 billion as of July 2, 2006 and \$938.9 million as of December 31, 2005. For the three and nine months ended October 1, 2006, we generated \$46.8 million and \$195.8 million, respectively, in cash provided by operations as compared to \$77.5 million and \$196.7 million, respectively during the three and nine months ended October 2, 2005.

During the three months ended July 2, 2006, we completed the sale of our Gresham, Oregon semiconductor manufacturing facility to ON Semiconductor for approximately \$105.0 million in cash. Under the terms of the agreement, ON Semiconductor offered employment to substantially all of the LSI manufacturing employees based at the Gresham site, with the remaining non-manufacturing workforce expected to continue their employment with LSI. ON Semiconductor also entered into additional agreements with LSI, including a multi-year wafer supply and test agreement, intellectual property license agreement, transition services agreement and a facilities use agreement. We also completed the sale of our ZSP digital signal processor technology during the three months ended July 2, 2006 (See Note 3 of the Notes).

[Table of Contents](#)

On October 25, 2006, we announced that we entered into a definitive agreement to acquire StoreAge Networking Technologies Ltd. ("StoreAge") for approximately \$50 million in cash. StoreAge, a privately held company based in Nesher, Israel with US offices in Irvine, California, provides SAN storage management and multi-tiered, data protection software for the enterprise. Under terms of the agreement, LSI will acquire all outstanding StoreAge capital stock. Additionally, LSI anticipates offering employment to all StoreAge employees, who are expected to join our Storage Systems segment upon closing. The transaction is expected to close in the fourth quarter of 2006 and is subject to satisfaction of customary closing conditions.

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full.

Where more than one significant factor contributed to changes in results from year to year, we have quantified such factors throughout Management's Discussion & Analysis, where practicable.

RESULTS OF OPERATIONS

Revenues:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Semiconductor segment	\$313.3	\$311.7	\$ 919.1	\$ 940.9
Storage Systems segment	179.7	170.0	539.4	472.1
Consolidated	\$493.0	\$481.7	\$1,458.5	\$1,413.0

There were no significant intersegment revenues during the periods presented.

Three months ended October 1, 2006 compared to the three months ended October 2, 2005

Total consolidated revenues for the three months ended October 1, 2006 increased \$11.3 million or 2.3% as compared to the three months ended October 2, 2005.

Semiconductor segment:

Revenues for the Semiconductor segment increased \$1.6 million or 0.5% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. The increase in semiconductor revenues is attributable to the net effect of the following factors:

- Revenues increased for semiconductors used in storage product applications due to increases in demand for hard disk drives and server products, and higher demand for semiconductors used in storage standard product applications such as Serial Attached SCSI ("SAS") products;
- Revenues increased for semiconductors used in communication product applications such as routers, switches and wide area network ("WAN") products.

The above noted increases were offset in part by decreases in revenues for semiconductors used in consumer product applications such as DVD-recorders, digital audio players and videogame products.

Storage Systems segment:

Revenues for the Storage Systems segment increased \$9.7 million or 5.7% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. The increase in revenues is primarily attributable to increased demand across all product lines, including controller modules, integrated storage modules, drives, software, kits and other products.

Nine months ended October 1, 2006 compared to the nine months ended October 2, 2005

Total consolidated revenues for the nine months ended October 1, 2006 increased \$45.5 million or 3.2% as compared to the nine months ended October 2, 2005.

Semiconductor segment:

Revenues for the Semiconductor segment decreased \$21.8 million or 2.3% for the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. The decrease in semiconductor revenues is primarily attributable to the net effect of the following factors:

- Revenues decreased for semiconductors used in consumer product applications primarily a result of lower demand for videogame products and DVD-recorders.

The above noted decreases were offset in part by increases in revenues for semiconductors used in storage standard product applications such as SAS products, higher demand for semiconductors used in storage custom solutions product applications such as hard disk drives and server products, and increased demand for semiconductors used in communication product applications such as switches and WAN products and increased demand for semiconductors used in consumer product applications such as cable set-top box solutions.

Storage Systems segment:

Revenues for the Storage Systems segment increased \$67.3 million or 14.3% for the nine months ended October 1, 2006 compared to the same period of 2005. The increase in revenues is primarily attributable to increased demand for a high-end controller product we introduced in June 2005, along with associated products such as drives, software and kits.

Significant Customers. The following table summarizes the number of our significant customers, each of whom accounted for 10% or more of our revenues, along with the percentage of revenues they individually represent on a consolidated basis and by segment:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Semiconductor segment:				
Number of significant customers	1	2	1	1
Percentage of segment revenues	19%	16%,12%	19%	17%
Storage Systems segment:				
Number of significant customers	3	2	2	3
Percentage of segment revenues	45%,15%,10%	46%,11%	45%,15%	43%,13%,10%
Consolidated:				
Number of significant customers	2	2	2	2
Percentage of consolidated revenues	17%,12%	17%,11%	18% 12%	15%,11%

Revenues by geography. The following table summarizes our revenues by geography:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
(in millions)				
Revenues:				
North America	\$219.9	\$230.8	\$ 692.4	\$ 666.4
Asia, including Japan	224.3	193.1	605.3	583.8
Europe	48.8	57.8	160.8	162.8
Total	\$493.0	\$481.7	\$1,458.5	\$1,413.0

Three months ended October 1, 2006 compared to the three months ended October 2, 2005

For the three months ended October 1, 2006, revenues decreased in North America and Europe and increased in Asia, including Japan, as compared to the three months ended October 2, 2005. The decrease in North America is attributable to a decrease in demand for semiconductors used in consumer product applications such as digital audio players and decreased revenues for semiconductors used in storage product applications due to the continued shift of revenues to Asia. The decrease was offset in part by increased demand for semiconductors used in communication product applications such as WAN products and increased revenues within the Storage Systems segment. The increase in Asia, including Japan, is primarily a result of increases in demand for semiconductors used in storage product applications such as hard disk drives and server products and Host Bus Adapters (“HBA”) products and increased revenues in semiconductors used in storage standard product applications such as SAS products as well as increased demand for semiconductors used in communication product applications as revenues continue to shift to Asia from other regions for custom solutions. The increase was offset in part by decreased demand for semiconductors used in consumer product applications such as videogame products and DVD-recorders. The decrease in Europe is primarily attributable to decreases in revenues for semiconductors used in consumer product applications such as DVD-recorders and a decrease in demand within the Storage System segment.

Nine months ended October 1, 2006 compared to the nine months ended October 2, 2005

For the nine months ended October 1, 2006, revenues increased in North America and Asia, including Japan and decreased in Europe as compared to the nine months ended October 2, 2005. The increase in North America is attributable to an increase in demand within the Storage System segment, offset in part by declines in demand for semiconductors used in storage product applications due to the continued shift in revenues to Asia and declines in demand for semiconductors used in consumer product applications such as DVD-recorders and decreased revenues for semiconductors used in communication product applications such as wireless products. Revenues in Asia, including Japan, increased for the nine months ended October 1, 2006 as compared to the same period of 2005. The increase in revenues in Asia, including Japan, is attributable to increased demand for semiconductors used in storage product applications such as hard disk drives and server products and storage standard product applications such as SAS products as well as increased revenues for semiconductors used in communication product applications as revenues continue to shift to Asia from other regions for semiconductors used in storage custom solutions product applications. The increase was offset in part by decreases in demand for semiconductors used in consumer product applications such as videogame products and DVD-recorders. The decrease in Europe is primarily attributable to decreases in revenues for semiconductors used in communication product applications due to the continued shift in revenues to Asia and declines in revenues for semiconductors used in consumer product applications such as DVD-recorders and decreased demand within the Storage System segment, offset in part by increases in revenues for semiconductors used in storage product applications.

Operating costs and expenses. Key elements of the consolidated statements of operations for the respective segments are as follows:

Gross profit margin:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
	(in millions)			
Semiconductor segment	\$149.5	\$147.3	\$439.1	\$447.8
Percentage of revenues	48%	47%	48%	48%
Storage Systems segment	\$ 65.0	\$ 62.7	\$189.1	\$163.9
Percentage of revenues	36%	37%	35%	35%
Consolidated	\$214.5	\$210.0	\$628.2	\$611.7
Percentage of revenues	44%	44%	43%	43%

Three months ended October 1, 2006 compared to the three months ended October 2, 2005

The consolidated gross profit margin as a percentage of revenues remained relatively flat for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005.

[Table of Contents](#)

Semiconductor segment:

The gross profit margin as a percentage of revenues for the Semiconductor segment increased to 47.7% for the three months ended October 1, 2006 from 47.3% for the three months ended October 2, 2005. A more detailed description of factors affecting the gross profit margins for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005 is as follows:

- A favorable shift in product mix toward more high-margin semiconductors used in storage and communication product applications and lower prices from our foundry partners for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. These improvements were offset by:
 - Less favorable manufacturing variances for the three months ended October 1, 2006 as compared to the three months ended in October 2, 2005 as we sold the Gresham manufacturing facility in the three months ended July 2, 2006,
 - An unfavorable, one-time cash settlement originally associated with a manufacturing issue with a supplier,
 - Stock-based compensation expense associated with the adoption of SFAS 123R as of January 1, 2006. (See Note 2 of the Notes), and
 - Lower sales of previously reserved inventory and increased charges for non-marketable inventory.

Storage Systems segment:

The gross profit margin as a percentage of revenues for the Storage Systems segment decreased to 36.2% for the three months ended October 1, 2006 from 36.9% for the three months ended October 2, 2005. The decrease in gross profit margins is attributable to start-up costs related to the introduction of our new mid-range system product and stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006.

Nine months ended October 1, 2006 compared to the nine months ended October 2, 2005

The consolidated gross profit margin as a percentage of revenues was flat for the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. The consolidated gross margin as a percentage of revenues was 43.1% and 43.3% for the nine months ended October 1, 2006 and October 2, 2005, respectively.

Semiconductor segment:

The gross profit margin as a percentage of revenues for the Semiconductor segment was flat for the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. The Semiconductor segment gross margin as a percentage of revenues was 47.8% and 47.6% for the nine months ended October 1, 2006 and October 2, 2005, respectively. A more detailed description of factors affecting the gross profit margins for the nine months ended October 1, 2006 as compared to the same period of 2005 is as follows:

- A favorable shift in product mix toward more high-margin semiconductors used in storage and communication product applications and lower prices from our foundry partners for the nine months ended October 1, 2006 than for the nine months ended October 2, 2005. These improvements offset by:
 - Higher charges for non-marketable inventory,
 - Lower average selling prices for semiconductors used in consumer products,
 - An unfavorable, one time cash settlement originally associated with a manufacturing issue with a supplier, and
 - Stock-based compensation expense associated with the adoption of SFAS 123R as of January 1, 2006. (See Note 2 of the Notes.)

Storage Systems segment:

The gross profit margin as a percentage of revenues for the Storage Systems segment remained relatively flat for the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. The Storage Systems segment gross margin as a percentage of revenues was 35.1% and 34.7% for the nine months ended October 1, 2006 and October 2, 2005, respectively. The

[Table of Contents](#)

increase in gross profit margins is attributable to improved product mix associated with the introduction of our new high-end controller product in June of 2005 and material cost reductions for the nine months ended October 1, 2006. These increases were offset in part by the start-up costs related to the introduction of our new mid-range system product and stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006.

We own our Storage Systems segment manufacturing facility in Wichita, Kansas. In addition, we acquire wafers, assembly and test services from vendors in Taiwan, Japan, Malaysia, Korea, Mexico, Thailand, Singapore and China and outsource a portion of our Storage Systems segment manufacturing to facilities in Ireland. Utilizing diverse manufacturing locations allows us to better manage potential disruption in the manufacturing process due to economic and geographic risks associated with each location.

In the second quarter of 2006, we completed the sale of our Gresham, Oregon semiconductor manufacturing facility to ON Semiconductor for approximately \$105.0 million in cash. Under the terms of the agreement, ON Semiconductor offered employment to substantially all of the LSI manufacturing employees based at the Gresham site, with the remaining non-manufacturing workforce expected to continue their employment with LSI. ON Semiconductor also entered into additional agreements with LSI, including a multi-year wafer supply and test agreement, intellectual property license agreement, transition services agreement and a facilities use agreement (See Note 3 of the Notes).

Our operating environment, combined with the resources required to operate in the Semiconductor and Storage Systems industries, requires that we manage a variety of factors. These factors include, among other things:

- Competitive pricing pressures;
- Product mix;
- Factory capacity and utilization;
- Geographic location of manufacturing;
- Unexpected changes in regulatory requirements;
- Foreign technical standards;
- Manufacturing yields;
- Availability of certain raw materials;
- Adoption of new industry standards;
- Terms negotiated with third-party subcontractors; and
- Foreign currency fluctuations.

These and other factors could have a significant effect on our gross profit margin in future periods.

Research and development:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
		(in millions)		
Semiconductor segment	\$ 77.0	\$ 75.9	\$236.3	\$232.7
Percentage of revenues	25%	24%	26%	25%
Storage Systems segment	\$ 25.5	\$ 25.1	\$ 68.9	\$ 68.6
Percentage of revenues	14%	15%	13%	15%
Consolidated	\$102.5	\$101.0	\$305.2	\$301.3
Percentage of revenues	21%	21%	21%	21%

Three months ended October 1, 2006 compared to the three months ended October 2, 2005

Research and development ("R&D") expenses increased \$1.5 million or 1.5% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005.

[Table of Contents](#)

Semiconductor segment:

R&D expenses in the Semiconductor segment increased \$1.1 million or 1.4% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. R&D expenses for the Semiconductor segment increased primarily as the result of an increase in stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006 and higher compensation-related expenses, offset by lower depreciation and amortization-related expenses and lower spending on design engineering programs.

Storage Systems segment:

R&D expenses in the Storage Systems segment remained relatively flat for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. R&D expenses as a percentage of Storage Systems segment revenues were 14.2% for the three months ended October 1, 2006 as compared to 14.8% for the same period of 2005 due to an increase in revenues for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005, offset in part by an increase in stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006.

Nine months ended October 1, 2006 compared to the nine months ended October 2, 2005

R&D expenses increased \$3.9 million or 1.3% during the first nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005.

Semiconductor segment:

R&D expenses in the Semiconductor segment increased \$3.6 million or 1.5% in the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. The increase in R&D expenses for the Semiconductor segment is primarily the result of an increase in stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006, and higher compensation-related expenses, offset primarily by lower depreciation and amortization-related expenses and lower spending on design engineering programs.

Storage Systems segment:

R&D expenses in the Storage Systems segment remained relatively flat for the nine months ended October 1, 2006 as compared to the same period of 2005. R&D expenses as a percentage of Storage Systems segment revenues were 12.8% for the nine months ended October 1, 2006 as compared to 14.5% for the same period of 2005 due to an increase in revenues period over period, offset in part by an increase in stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006.

Selling, general and administrative:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Semiconductor segment	\$38.1	\$37.0	\$121.6	\$112.5
Percentage of revenues	12%	12%	13%	12%
Storage Systems segment	\$22.2	\$22.0	\$ 72.2	\$ 65.4
Percentage of revenues	12%	13%	13%	14%
Consolidated	\$60.3	\$59.0	\$193.8	\$177.9
Percentage of revenue	12%	12%	13%	13%

Three months ended October 1, 2006 compared to the three months ended October 2, 2005

Consolidated selling, general and administrative ("SG&A") expenses increased \$1.3 million or 2.2% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. Silicon Graphics ("SGI"), a customer of ours, filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code on May 8, 2006. On October 17, 2006, SGI emerged from bankruptcy. Based on the court approved repayment plan, we released \$1.7 million of the \$6.9 million in reserves established in the first and second quarters of 2006. We plan to release the remaining reserves for the SGI matter based on receipt of cash pursuant to the repayment plan approved by the court, which calls for payments to be made in installments throughout the fourth quarter of 2006 and first quarter of 2007. The remaining reserves mainly relate to the Storage Systems segment. We perform ongoing credit evaluations of our customers' financial condition and require collateral as considered necessary.

[Table of Contents](#)

Semiconductor segment:

SG&A expenses for the Semiconductor segment increased \$1.1 million or 3.0% for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. The increase in the Semiconductor segment was primarily due to an increase in stock-based compensation associated with SFAS 123R (See Note 2 of the Notes), offset in part by lower sales commissions.

Storage Systems segment:

SG&A expenses for the Storage Systems segment remained relatively flat for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. SG&A expenses as a percentage of Storage Systems segment revenues were 12.4% for the three months ended October 1, 2006 as compared to 12.9% for the same period of 2005 due to an increase in revenues for the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. In addition, we released \$1.7 million in reserves associated with the SGI matter, as discussed above. The decreases were offset in part by an increase in stock-based compensation expense associated with the adoption of SFAS 123R on January 1, 2006.

Nine months ended October 1, 2006 compared to the nine months ended October 2, 2005

Consolidated SG&A expenses increased \$15.9 million or 8.9% during the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. SGI, a customer of ours, filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code on May 8, 2006. As a result of this action, we recorded a \$5.2 million charge for the nine months ended October 1, 2006 because we do not believe the receivable balance as of October 1, 2006 is collectible. This \$5.2 million charge is net of the \$1.7 million reserve reversal discussed above. The majority of this charge related to the Storage Systems segment. We perform ongoing credit evaluations of our customers' financial condition and require collateral as considered necessary.

Semiconductor segment:

SG&A expenses for the Semiconductor segment increased \$9.1 million or 8.1% for the nine months ended of October 1, 2006 as compared to the same period of 2005. The increase in the Semiconductor segment was primarily due to an increase in stock-based compensation associated with SFAS 123R (See Note 2 of the Notes), offset in part by lower sales commissions and professional services.

Storage Systems segment:

SG&A expenses for the Storage Systems increased \$6.8 million or 10.4% for the nine months ended October 1, 2006 as compared to the same period of 2005. The increase in SG&A expenses is mainly due to the following:

- A \$5.0 million net charge recorded for the nine months ended October 1, 2006 to reduce a receivable balance with Silicon Graphics, as discussed above;
- Stock-based compensation associated with the adoption of SFAS 123R.

Restructuring of operations and other items: We recorded a charge of \$2.6 million and a net credit of \$13.4 million in restructuring of operations and other items for the three and nine months ended October 1, 2006, respectively. A charge of \$2.7 million and a credit of \$14.6 million was recorded in the Semiconductor segment and a credit of \$0.1 million and a charge of \$1.2 million was recorded in the Storage Systems segment for the three and nine months ended October 1, 2006, respectively. We recorded charges of \$100.0 million and \$108.7 million in restructuring of operations and other items for the three and nine months ended October 2, 2005, respectively, primarily in the Semiconductor segment. (See Note 3 of the Notes.)

Stock-based compensation: On January 1, 2006, we adopted SFAS 123R, using the modified prospective transition method. Using the modified prospective transition method of adopting SFAS 123R, we began recognizing compensation expense for all share-based awards granted after January 1, 2006 plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made. Stock-based compensation expense under SFAS 123R in the consolidated condensed statements of operations for the three and nine months ended October 1, 2006 was \$11.0 million and \$36.2 million, respectively.

[Table of Contents](#)

The estimated fair value of our equity-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis. The implementation of SFAS 123R did not have a significant impact on cash flows from operations during the three and nine months ended October 1, 2006. (See Note 2 to the Notes for a further discussion on stock-based compensation.)

Amortization of intangibles: Amortization of intangible assets was \$6.4 million and \$28.5 million for the three and nine months ended October 1, 2006, respectively, as compared to \$15.7 million and \$50.9 million for the three and nine months ended October 2, 2005, respectively. The decrease is primarily a result of certain intangible assets becoming fully amortized during 2005 and during the nine months ended October 1, 2006 and also due to the write-off of certain intangible assets acquired in a purchase business combination for the three months ended July 2, 2006. As of October 1, 2006, we had approximately \$14.2 million of intangible assets, net of accumulated amortization that will continue to amortize.

Interest expense: Interest expense increased slightly by \$0.5 million to \$6.6 million for the three months ended October 1, 2006 from \$6.1 million for the three months ended October 2, 2005. The increase is due to a lower benefit from the amortization of the deferred gain on the terminated swap. Interest expense increased slightly by \$0.2 million to \$19.3 million for the nine months ended October 1, 2006 from \$19.1 million for the nine months ended October 2, 2005. The increase is due to a lower benefit from the amortization of the deferred gain on the terminated swaps, offset by a lower debt balance from the repurchase of \$149.7 million of the 2001 Convertible Notes in the second quarter of 2005.

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full (see Note 6 of the Notes).

Interest income and other, net: Interest income and other, net, was \$13.1 million for the three months ended October 1, 2006 as compared to \$4.6 million for the three months ended October 2, 2005. Interest income increased to \$13.5 million for the three months ended October 1, 2006 from \$6.3 million for the three months ended October 2, 2005. The increase in interest income is mainly due to higher returns and higher average cash and short-term investment balances during the three months ended October 1, 2006 as compared to the three months ended October 2, 2005. Other expenses, net of \$0.4 million for the three months ended October 1, 2006 included a \$1.2 million charge for points on foreign currency forward contracts, offset in part by a pre-tax gain of \$0.8 million on the sale of certain marketable available-for-sale equity securities (see Note 4 of the Notes) and other miscellaneous items. Other expense, net of \$1.7 million for the three months ended October 2, 2005 included a pre-tax loss of \$1.5 million on impairment of certain non-marketable available-for-sale equity securities (see Note 4 of the Notes) and other miscellaneous items.

Interest income and other, net increased to \$32.9 million during the nine months ended October 1, 2006 as compared to \$21.5 million for the nine months ended October 2, 2005. Interest income increased to \$34.6 million during the first nine months of 2006 from \$17.9 million for the same period of 2005. The increase in interest income is mainly due to higher returns and higher average cash and short-term investment balances for the nine months ended October 1, 2006 as compared to the nine months ended October 2, 2005. Other expenses, net of \$1.7 million for the nine months ended October 1, 2006, included a \$3.4 million charge for points on foreign currency forward contracts, a pre-tax loss of \$0.2 million on the sale of certain marketable available-for-sale equity securities of a certain technology company that was acquired by another company for the three months ended July 2, 2006, offset in part by a pre-tax gain of \$2.2 million on the sale of certain marketable available-for-sale equity securities (See Note 4 of the Notes). Other income, net of \$3.6 million in the first nine months of 2005 included a pre-tax gain of \$4.1 million on the repurchase of the 2001 Convertible Notes, a pre-tax gain of \$2.9 million on sales of certain marketable available-for-sale equity securities, a pre-tax loss of \$1.5 million for the impairment of certain non-marketable available-for-sale equity securities for the three months ended October 2, 2005 and other miscellaneous items.

Provision for income taxes: During the three and nine months ended October 1, 2006 we recorded an income tax provision of \$5.6 million and \$17.2 million, respectively. For the three and nine months ended October 2, 2005, we recorded an income tax provision of \$6.3 million and \$18.8 million, respectively. The provision primarily related to foreign income taxes.

The provision for income taxes for the three months ended October 1, 2006 includes tax benefits of \$0.5 million relating to a tax clearance received from a foreign jurisdiction which was treated as a discrete item allocable to the quarter.

Excluding certain foreign jurisdictions, our management believes that the future benefit of deferred tax assets, including stock based compensation awards, is not more likely than not to be realized. Accordingly, a full valuation allowance has been established against the net deferred tax asset.

FINANCIAL CONDITION, CAPITAL RESOURCES AND LIQUIDITY

Cash, cash equivalents and short-term investments increased to \$1.3 billion at October 1, 2006, from \$938.9 million at December 31, 2005. The increase is mainly due to cash and cash equivalents provided by operating and financing activities, partially offset by net cash outflows for investing activities as described below.

Working capital. Working capital increased by \$216.6 million to \$1.1 billion at October 1, 2006, from \$877.4 million as of December 31, 2005. The increase in working capital is primarily attributable to the following activities:

- Cash, cash equivalents and short-term investments increased by \$329.2 million.
- Other accrued liabilities decreased by \$4.3 million due to decreases in the restructuring reserve (Note 3 of the Notes) and miscellaneous accruals, offset in part by increases in the interest accrual related to the Convertible Subordinated Notes.
- Accounts payable decreased by \$2.1 million due to the timing of invoice receipt and payments.
- Accrued salaries, wages and benefits decreased by \$2.1 million primarily due to timing differences in payment of salaries, benefits and performance-based compensation.
- Current portion of long-term obligation decreased by \$1.9 million due to the amortization of deferred gain on the terminated swaps.

The increase in working capital was offset, in part, by the following:

- Prepaid expenses and other current assets decreased by \$99.1 million primarily due to decreases in assets held for sale due to the sale of our Gresham, Oregon manufacturing facility and two Colorado facilities, and a decrease in prepaid software maintenance.
- Inventories decreased by \$11.1 million to \$183.7 million as of October 1, 2006, from \$194.8 million as of December 31, 2005. The decline in inventory levels reflects a) our continued focus on supply chain management and b) inventory sold to ON Semiconductor as part of the sale of the Gresham manufacturing facility.
- Income taxes payable increased by \$9.8 million due to the timing of income tax payments made and the income tax provision recorded during the nine months ended October 1, 2006.
- Accounts receivable decreased by \$3.1 million to \$320.3 million as of October 1, 2006 from \$323.3 million as of December 31, 2005. The decrease is mainly attributed to lower revenues during the three months ended October 1, 2006 as compared to the three months ended December 31, 2005.

Cash and cash equivalents generated from operating activities. During the nine months ended October 1, 2006, we generated \$195.8 million of net cash and cash equivalents from operating activities compared to \$196.7 million generated during the nine months ended October 2, 2005. Cash and cash equivalents generated by operating activities for the nine months ended October 1, 2006, were the result of the following:

- Net income adjusted for non-cash transactions. The non-cash items and other non-operating adjustments are quantified in our Consolidated Condensed Statements of Cash Flows included in this Form 10-Q; and
- A net increase in assets and liabilities, including changes in working capital components from December 31, 2005 to October 1, 2006, as discussed above.

The adoption of SFAS 123R did not have an impact on cash flows from operations for the nine months ended October 1, 2006.

Cash and cash equivalents used in investing activities. Cash and cash equivalents used in investing activities were \$98.6 million for the nine months ended October 1, 2006, as compared to \$52.4 million provided by investing activities for the nine months ended October 2, 2005. The primary investing activities for the nine months ended October 1, 2006 were as follows:

Table of Contents

- Purchases of debt and equity securities available for sale, net of sales and maturities; and
- Proceeds from the sale of the Gresham, Oregon manufacturing facility, two Colorado facilities and intellectual property, net of purchases of property, equipment and software.
- The receipt of an income tax refund for pre-acquisition tax matters associated with an acquisition in 2001.

We expect capital expenditures to be approximately \$45.0 million in 2006. In recent years, we have reduced our level of capital expenditures as a result of our focus on establishing strategic supplier alliances with foundry semiconductor manufacturers, which enables us to have access to advanced manufacturing capacity, and reduces our capital spending requirements.

Cash and cash equivalents provided by/ (used in) financing activities. Cash and cash equivalents provided by financing activities for the nine months ended October 1, 2006 were \$36.0 million as compared to \$128.2 million used in financing activities for the nine months ended October 2, 2005. The primary financing activities for the nine months ended October 1, 2006 were the issuance of common stock under our employee stock option and purchase plans.

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full.

We may seek additional equity or debt financing from time to time. We believe that our existing liquid resources and funds generated from operations, combined with funds from such financing and our ability to borrow funds will be adequate to meet our operating and capital requirements and obligations for the foreseeable future. However, we cannot be certain that additional financing will be available on favorable terms. Moreover, any future equity or convertible debt financing will decrease the percentage of equity ownership of existing stockholders and may result in dilution, depending on the price at which the equity is sold or the debt is converted.

Contractual Obligations

The following table summarizes our contractual obligations at October 1, 2006, and the effect of these obligations is expected to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments due by period				Total
	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	
Convertible Subordinated Notes	\$271.8	\$ —	\$350.0	\$ —	\$ 621.8
Operating lease obligations	48.5	78.4	38.9	11.5	177.3
Purchase commitments	413.9	35.5	—	—	449.4
Total	\$734.2	\$113.9	\$388.9	\$11.5	\$1,248.5

Convertible Subordinated Notes

As of October 1, 2006, we had \$271.8 million of Convertible Subordinated Notes due in November 2006 (“2001 Convertible Notes”) and \$350.0 million of Convertible Subordinated Notes due in May 2010 (“2003 Convertible Notes”). All of the Convertible Notes are subordinated to all existing and future senior debt and are convertible at the holder’s option, at any time prior to the maturity date of the Convertible Notes, into shares of our common stock. The 2001 and 2003 Convertible Notes have conversion prices of approximately \$26.34 per share and \$13.42 per share, respectively. The 2001 Convertible Notes are redeemable at our option, in whole or in part, on at least 30 days notice at any time on or after the call date, which is two years before the due date. We cannot elect to redeem the 2003 Convertible Notes prior to maturity. Each holder of the 2001 and 2003 Convertible Notes has the right to cause us to repurchase all of such holder’s convertible notes at 100.0% of their principal amount plus accrued interest upon the occurrence of any fundamental change to us, which includes a transaction or event such as an exchange offer, liquidation, tender offer, consolidation, merger or combination. Interest is payable semiannually.

On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full.

[Table of Contents](#)

Fluctuations in our stock price impact the prices of our outstanding convertible securities and the likelihood of the convertible securities being converted into cash or equity. If we are required to redeem any of the Convertible Notes for cash, that is, they are not converted to equity, it may affect our liquidity position. We believe that our current cash position and expected future operating cash flows will be adequate to meet these obligations as they mature. From time to time, we redeem or repurchase Convertible Notes.

Operating Lease Obligations

We lease real estate, certain non-manufacturing equipment and software under non-cancelable operating leases.

Purchase Commitments

We maintain certain purchase commitments, primarily for raw materials, with suppliers and for some non-production items. Purchase commitments for inventory materials are generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among our different suppliers.

In connection with the sale of the Gresham, Oregon manufacturing facility in May 2006, we entered into a multi-year wafer supply agreement. The wafer supply agreement includes a minimum purchase commitment whereby LSI has agreed to purchase \$198.8 million in wafers from ON Semiconductor from the date of the sale through the second quarter of 2008. These commitments have been included in the table above.

On October 25, 2006, we announced that we entered into a definitive agreement to acquire StoreAge Networking Technologies Ltd. ("StoreAge") for approximately \$50 million in cash. StoreAge, a privately held company based in Nesher, Israel with US offices in Irvine, California, provides SAN storage management and multi-tiered, data protection software for the enterprise. The transaction is expected to close in the fourth quarter of 2006.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures. For a detailed discussion of our critical accounting policies, please see the Critical Accounting Policies contained in Part II, Item 7 of the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2005. A new critical accounting policy has been added with the adoption of SFAS 123R effective January 1, 2006.

Stock-Based compensation

On January 1, 2006, we adopted SFAS 123R, using the modified prospective transition method. In accordance with the modified prospective transition method, we began recognizing compensation expense for all share-based awards granted after January 1, 2006 plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made. Stock-based compensation expense under SFAS 123R in the consolidated condensed statements of operations for the three and nine months ended October 1, 2006 was \$11.0 million and \$36.2 million, respectively. Stock-based compensation costs capitalized to inventory and software for the three and nine months ended October 1, 2006 were not significant. See Note 2 of the Notes for a description of our equity compensation plans and a more detailed discussion of the adoption of SFAS 123R.

Stock Options

The fair value of each option grant is estimated on the date of grant using a reduced form calibrated binomial lattice model ("the Lattice Model"). This model requires the use of historical data for employee exercise behavior and the use of assumptions as follows:

Employee Stock Options Granted	Three months ended October 1, 2006	Nine months ended October 1, 2006
Weighted average estimated grant date fair value	\$2.97	\$3.30
Weighted average assumptions in calculation:		
Expected life (years)	4.36	4.32
Risk-free interest rate	5%	5%
Volatility	48%	48%
Dividend yield	—	—

[Table of Contents](#)

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the Lattice Model. The expected life of employee stock options is impacted by all of the underlying assumptions and calibration of our model.

We used an equally weighted combination of historical and implied volatilities as of the grant date. The historical volatility is the standard deviation of the daily stock returns for LSI from the date of our initial public offering in 1983. We used implied volatilities of near-the-money LSI traded call options since stock options are call options that are granted at the money. The historical and implied volatilities were annualized and equally weighted to determine the volatilities as of the grant date. Prior to January 1, 2006, we used historical implied stock price volatilities in accordance with SFAS 123 for purposes of its pro forma information. Our management believes that the equally weighted combination of historical and implied volatilities is more representative of future stock price trends than historical implied volatilities.

The risk-free interest rate assumption is based upon observed interest rates for constant maturity treasuries appropriate for the term of our employee stock options. The estimated kurtosis and skewness are technical measures of the distribution of stock price returns that are based on stock price return history as well as consideration of academic analyses.

The Lattice Model assumes that employees' exercise behavior is a function of the option's remaining vested life and the extent to which the option is in-the-money. The Lattice Model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations on all past option grants made by us since the initial public offering in 1983.

As stock-based compensation expense recognized in the consolidated condensed statement of operations for the three months ended October 1, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience. For our pro forma information required under SFAS 123 for the periods prior to January 1, 2006, we accounted for forfeitures as they occurred.

Employee Stock Purchase Plans

We also has two employee stock purchase plans ("ESPPs" — US ESPP and IESPP) under which rights are granted to all employees to purchase shares of common stock at 85.0% of the lesser of the fair market value of such shares at the beginning of a 12-month offering period or the end of each six-month purchase period within such an offering period, typically in May and November. Compensation expense is calculated using the fair value of the employees' purchase rights under the Black-Scholes model. During the three months ended July 2, 2006, a total of 1.9 million shares related to the ESPPs were issued. No shares were issued during the three months ended October 1, 2006. There were approximately 20.1 million shares of common stock reserved for issuance under the ESPPs as of October 1, 2006. The stock-based compensation expense for the three months ended October 1, 2006 stemming from the May 14, 2006 ESPP grants was not significant because the majority of our employees enrolled in the 12-month purchase period in November of 2005 and will not re-enroll until November of 2006. For disclosure purposes, we have included the assumptions that went into the calculation of fair value for the May 2006 as follows:

Employee Stock Purchase Plans Granted	Three months ended July 2, 2006
Weighted average estimated grant date fair value	\$3.05
Weighted average assumptions in calculation:	
Expected life (years)	0.8
Risk-free interest rate	5%
Volatility	39%
Dividend yield	—

Restricted Stock Awards

The cost of these awards is determined using the fair value of our common stock on the date of the grant and compensation expense is recognized over the vesting period on a straight-line basis.

Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective assumptions. We use third-party

[Table of Contents](#)

consultants to assist in developing the assumptions used in as well as calibrating the Lattice Model. We are responsible for determining the assumptions used in estimating the fair value of its share based payment awards. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because our employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management's opinion, the existing valuation models may not provide an accurate measure of the fair value of our employee stock options. Although, the fair value of employee stock options is determined in accordance with SFAS 123R and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Recent Accounting Pronouncements

The information contained in Item 1 of Note 1 of the Notes under the heading "Recent Accounting Pronouncements" is hereby incorporated by reference into this Item 2.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no significant changes in the market risk disclosures during the three months ended October 1, 2006, as compared to the discussion in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2005.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures: The Securities and Exchange Commission defines the term "disclosure controls and procedures" to mean a company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 ("Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required or necessary disclosures. Our chief executive officer and chief financial officer have concluded, based on the evaluation of the effectiveness of the disclosure controls and procedures by our management, with the participation of our chief executive officer and chief financial officer, as of the end of the period covered by this report, that our disclosure controls and procedures were effective for this purpose.

Changes in Internal Controls: During the fiscal quarter covered by this report, we did not make any change in our internal control over financial reporting that materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

This information is included in Note 11 ("Legal Matters") of the Notes to the Unaudited Consolidated Condensed Financial Statements, which information is incorporated herein by reference from Item 1 of Part I hereof.

Item 1A. Risk Factors

We are subject to a number of risks. Some of these risks are endemic to the semiconductor industry and are the same or similar to those disclosed in our previous SEC filings, and some relate specifically to the Company. In addition, new unforeseen risks may arise in the future. The reader should carefully consider all of these risks and other information in this Form 10-Q before investing in our stock. The fact that certain risks are endemic to the high-technology industry does not lessen the significance of these risks.

As a result of these risks, our business, financial conditions or results of operations could be materially and adversely affected. This could cause the trading price of our common stock to decline, and stockholders might lose some or all of their investment.

Please consider these risk factors when you read "forward-looking" statements elsewhere in this Form 10-Q and in the documents incorporated herein by reference. Forward-looking statements are statements that relate to our expectations for future events and time periods. Generally, the words, "anticipate," "expect," "intend" and similar expressions identify forward-looking statements. Forward-

looking statements involve risks and uncertainties, and actual results could differ materially from those anticipated in the forward-looking statements.

General economic weakness and geopolitical factors may harm our operating results and financial condition. The semiconductor industry is cyclical in nature and is characterized by wide fluctuations in product supply and demand. In the past, the industry has experienced periods of rapid expansion of production capacity followed by periods of significant downturn. Even when the demand for our products remains constant, the availability of additional excess production capacity in the industry creates competitive pressures that can degrade pricing levels, which can reduce revenues. In addition, our results of operations are dependent on the global economy. Any geopolitical factors such as terrorist activities, armed conflict or global health conditions, which adversely affect the global economy, may adversely impact our operating results and financial condition. In addition, goodwill and other long-lived assets could be impacted by a decline in revenues because impairment is measured based upon estimates of future cash flows. These estimates include assumptions about future conditions within our company and industry.

We depend entirely on independent foundry subcontractors to manufacture our semiconductor products; accordingly, any failure to secure and maintain sufficient foundry capacity could materially and adversely affect our business. During the three months ended July 2, 2006, we completed the sale of the Gresham, Oregon semiconductor manufacturing facility to ON Semiconductor. As a result of this transaction, we are completely dependent on foundry subcontractors for the manufacture of our semiconductor products. In conjunction with the sale of the facility, we entered into a wafer supply and test agreement with ON Semiconductor. Other foundry subcontractors, located in Asia, currently manufacture the remainder of our semiconductor devices.

Availability of foundry capacity has in the recent past been reduced due to strong demand. In addition, the occurrence of a public health emergency could further affect the production capabilities of our manufacturers by resulting in quarantines or closures. If we are unable to secure sufficient capacity at our existing foundries, or in the event of a quarantine or closure at any of these foundries, our revenues, cost of revenues and results of operations would be negatively impacted. If any of our foundries experiences a shortage in capacity, or suffers any damage to its facilities due to earthquakes or other natural disasters, experiences power outages, encounters financial difficulties or experiences any other disruption of foundry capacity, we may need to qualify an alternative foundry in a timely manner. Even our current foundries need to have new manufacturing processes qualified if there is a disruption in an existing process. We typically require several months to qualify a new foundry or process before we can begin shipping products. We may experience a significant interruption in the supply of the affected products, depending on the success and timeliness of a qualification.

Because we rely exclusively on outside foundries with limited capacity, we face several significant risks, including:

- a lack of guaranteed wafer supply and potential wafer shortages and higher wafer prices;
- limited control over delivery schedules, quality assurance, manufacturing yields and production costs; and
- the unavailability of, or potential delays in obtaining access to, key process technologies.

In addition, the manufacture of integrated circuits is a highly complex and technologically demanding process. Although we work closely with our foundries to minimize the likelihood of reduced manufacturing yields, our foundries have, from time to time, experienced lower than anticipated manufacturing yields. This often occurs during the production of new products or the installation and start-up of new process technologies. Poor yields from our foundries could result in product shortages or delays in product shipments, which could seriously harm our relationships with our customers and materially and adversely affect our results of operations.

The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. Although we have entered into contractual commitments to supply specified levels of products to some of our customers, we do not have a long-term volume purchase agreement or a significant guaranteed level of production capacity with any of our foundries. Foundry capacity may not be available when we need it or at reasonable prices. Availability of foundry capacity has in the recent past been reduced from time to time due to strong demand. We place our orders on the basis of our customers' purchase orders or our forecast of customer demand, and the foundries can allocate capacity to the production of other companies' products and reduce deliveries to us on short notice. It is possible that other foundry customers that are larger and better financed than we are, or that have long-term agreements with our main foundries, may induce our foundries to reallocate capacity to them. This reallocation could impair our ability to secure the supply of components that we need. Although we use a number of independent foundries to manufacture our semiconductor products, most of our components are not manufactured at more than one foundry at any given time nor are our products typically designed to be manufactured in more than one specific process at. Accordingly, if one of our foundries is unable to

[Table of Contents](#)

provide us with components as needed, we could experience significant delays in securing sufficient supplies of those components. Also, our third party foundries typically migrate capacity to newer, state-of-the-art manufacturing processes on a regular basis, which may create capacity shortages for our products designed to be manufactured on an older process. We cannot assure you that any of our existing or new foundries will be able to produce integrated circuits with acceptable manufacturing yields, or that our foundries will be able to deliver enough semiconductor devices to us on a timely basis, or at reasonable prices. These and other related factors could impair our ability to meet our customers' needs and have a material and adverse effect on our operating results.

Although we may utilize new foundries for other products in the future, in using new foundries we will be subject to all of the risks described in the foregoing paragraphs with respect to our current foundries.

Our target markets are characterized by rapid technological change. The Semiconductor and Storage Systems segments in which we conduct business are characterized by rapid technological change, short product cycles and evolving industry standards. We believe our future success depends, in part, on our ability to improve on existing technologies and to develop and implement new ones in order to continue to reduce semiconductor chip size and improve product performance and manufacturing yields. We must also be able to adopt and implement emerging industry standards in a timely manner and to adapt products and processes to technological changes. If we are not able to implement new process technologies successfully or to achieve volume production of new products at acceptable yields, our operating results and financial condition may be adversely impacted.

We operate in highly competitive markets. Our competitors include many large domestic and foreign companies that have substantially greater financial, technical and management resources than we do. Several major diversified electronics companies offer custom solutions and/or other standard products that are competitive with our product lines. Other competitors are specialized, rapidly growing companies that sell products into the same markets that we target. Some of our large customers may also design and manufacture products that compete with our products. There is no assurance that the price and performance of our products will be superior relative to the products of our competitors. As a result, we may experience a loss of competitive position that could result in lower prices, fewer customer orders, reduced revenues, reduced gross profit margins and loss of market share.

We are dependent on a limited number of customers. A limited number of customers account for a substantial portion of our revenues. International Business Machines Corporation and Seagate Technology represented approximately 17% and 12%, respectively, of our total consolidated revenues for the three months ended October 1, 2006.

Our operating results and financial condition could be significantly affected if:

- we do not win new product designs from major existing customers;
- major customers reduce or cancel their existing business with us;
- major customers make significant changes in scheduled deliveries; or
- there are declines in the prices of products that we sell to these customers.

We are potentially subject to credit risk from accounts receivable. A majority of our trade receivables are derived from sales to large multinational computer, communication, networking, storage and consumer electronics manufacturers, with the remainder distributed across other industries. We perform ongoing credit evaluations of our customers' financial condition and require collateral when considered necessary. However, we cannot provide assurance that our accounts receivable balances will be paid on time or at all.

Our new products may not achieve market acceptance. We introduce many new products each year. We must continue to develop and introduce new products that compete effectively on the basis of price and performance and that satisfy customer requirements. Our cores and standard products are intended to be based upon industry standard functions, interfaces, and protocols so that they are useful in a wide variety of systems applications. Development of new products and cores often requires long-term forecasting of market trends, development and implementation of new or changing technologies and a substantial capital commitment. We cannot provide assurance that the cores or standard products that we select for investment of our financial and engineering resources will be developed or acquired in a timely manner or will enjoy market acceptance.

The storage manufacturing facility we operate is complex. We own our own Storage Systems segment manufacturing facility in Wichita, Kansas. The manufacture and introduction of our Storage Systems products is a complicated process. We confront challenges in the manufacturing process that require us to:

- maintain a competitive manufacturing cost structure;
- exercise stringent quality control measures to ensure high yields;
- effectively manage the subcontractors engaged in the wafer fabrication, test and assembly of products; and
- update equipment and facilities as required for leading edge production capabilities.

We procure parts and raw materials from a limited number of domestic and foreign sources. We do not maintain an extensive inventory of parts and materials for manufacturing. We purchase a portion of our requirements for parts and raw materials from a limited number of sources, primarily from suppliers in Japan and their U.S. subsidiaries, and we obtain other material inputs on a local basis. There is no assurance that, if we have difficulty in obtaining parts or materials in the future, alternative suppliers will be available, or that these suppliers will provide parts and materials in a timely manner or on favorable terms. As a result, we may be adversely affected by delays in product shipments. If we cannot obtain adequate materials for manufacture of our products or if such materials are not available at reasonable prices, there could be a material adverse impact on our operating results and financial condition.

We utilize indirect channels of distribution over which we have limited control. Our financial results could be adversely affected if our relationship with resellers or distributors were to deteriorate or if the financial condition of these resellers or distributors were to decline. In addition, as our business grows, we may have an increased reliance on indirect channels of distribution. There can be no assurance that we will be successful in maintaining or expanding these indirect channels of distribution. Failure to do so could result in the loss of certain sales opportunities. Furthermore, the partial reliance on indirect channels of distribution may reduce our visibility with respect to future business, thereby making it more difficult to accurately forecast orders.

We engage in acquisitions and alliances giving rise to financial and technological risks. We are continually exploring strategic acquisitions that build upon our existing library of intellectual property, human capital and engineering talent, and increase our leadership position in the markets where we operate. On October 25, 2006, we announced that we entered into a definitive agreement to acquire StoreAge Networking Technologies Ltd for approximately \$50 million in cash. StoreAge Networking Technologies, a privately held company based in Nesher, Israel with US offices in Irvine, California, provides SAN storage management and multi-tiered, data protection software for the enterprise. (See Note 12 of the Notes.) Mergers and acquisitions of high-technology companies bear inherent risks. No assurance can be given that our previous or future acquisitions will be successful and will not materially adversely affect our business, operating results or financial condition. We must continue to manage any growth effectively. Failure to manage growth effectively and to integrate acquisitions could adversely affect our operating results and financial condition.

In addition, we intend to continue to make investments in companies, products and technologies through strategic alliances. Investment activities often involve risks, including the need to acquire timely access to needed capital for investments related to alliances and to invest in companies and technologies that contribute to the growth of our business.

During the three months ended July 2, 2006, we completed the sale of the Gresham, Oregon manufacturing facility as part of our strategy to transition to a fabless semiconductor manufacturing model. Our new strategy includes the expansion of our working relationships with major foundry partners and the adoption of a roadmap leading to the production of advanced semiconductors utilizing 65-nanometer and below process technology on 300-mm or 12-inch wafers. As a result of this transaction, we are completely dependent on foundry subcontractors for the manufacture of our semiconductor products. In conjunction with the sale of the facility, we entered into other agreements with ON Semiconductor, including, but not limited to a wafer supply and test agreement and an intellectual property license agreement.

The price of our securities may be subject to wide fluctuations. Our stock has experienced substantial price volatility, particularly as a result of quarterly variations in results, the published expectations of analysts and announcements by our competitors and us. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many technology companies and that have often been unrelated to the operating performance of such companies. The price of our securities may also be affected by general global, economic and market conditions. While we cannot predict the individual effect that these and other factors may have on the price of our securities, these factors, either individually or in the aggregate, could result in significant variations in

stock price during any given period of time. These fluctuations in our stock price also impact the price of our outstanding convertible securities and the likelihood of the convertible securities being converted into cash or equity. If our stock price is below the conversion price of our convertible bonds on the date of maturity, they may not convert into equity and we may be required to redeem our outstanding convertible securities for cash. However, in the event they do not convert to equity, we believe that our current cash position and expected future operating cash flows will be adequate to meet these obligations as they mature.

We may rely on capital and bank markets to provide liquidity. In order to finance strategic acquisitions, capital assets needed in our manufacturing facilities and other general corporate needs, we may rely on capital and bank markets to provide liquidity. As of October 1, 2006, we had convertible notes outstanding of approximately \$622 million. On November 1, 2006, the 2001 Convertible Subordinated Notes in the amount of \$271.8 million became due and were repaid in full. We may need to seek additional equity or debt financing from time to time. Historically, we have been able to access capital and bank markets, but we may not be able to access these markets in the future or on terms that are acceptable to us. The availability of capital in these markets is affected by several factors, including geopolitical risk, the interest rate environment and the condition of the economy as a whole. Moreover, any future equity or equity-linked financing may dilute the equity ownership of existing shareholders. In addition, our own operating performance, capital structure and expected future performance impact our ability to raise capital. We believe that our current cash, cash equivalents, short-term investments and future cash provided by operations will be sufficient to fund our needs in the foreseeable future. This includes repaying our existing convertible debt when due. However, if our operating performance falls below expectations, we may need additional funds.

We design and develop highly complex semiconductors and storage systems. As technology advances to smaller geometries, there are increases in the complexity, time and expense associated with the design, development and manufacture of semiconductors. We must incur substantial research and development costs to confirm the technical feasibility and commercial viability of any products that in the end may not be successful. Therefore, we cannot guarantee that any new semiconductor or storage products will result in market acceptance.

The high technology industry in which we operate is prone to intellectual property litigation. Our success is dependent in part on our technology and other proprietary rights, and we believe that there is value in the protection afforded by our patents, copyright, trademarks and other intellectual property rights. We have a program whereby we actively protect our intellectual property by acquiring patent and other intellectual property rights. However, the industry is characterized by rapidly changing technology and our future success depends primarily on the technical competence and creative skills of our personnel.

As is typical in the high technology industry, from time to time we have received communications from other parties asserting that certain of our products, processes, technologies or information infringe upon their patent rights, copyrights, trademark or other intellectual property rights. We regularly evaluate such assertions. In light of industry practice, we believe, with respect to existing or future claims that any licenses or other rights that may be necessary may generally be obtained on commercially reasonable terms. Nevertheless, there is no assurance that licenses will be obtainable on acceptable terms or that a claim will not result in litigation or other administrative proceedings. Resolution of whether our product or intellectual property has infringed on valid rights held by others could have a material adverse effect on our results of operations or financial position and may require material changes in production processes and products.

See “Legal Matters” in Note 11 of the Notes regarding pending patent litigation.

We may not be able to adequately protect or enforce our intellectual property rights, which could harm our competitive position. Our success and future revenue growth will depend, in part, on our ability to protect our intellectual property. We primarily rely on patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies and processes. Despite our efforts to protect our proprietary technologies and processes, it is possible that competitors or other unauthorized third parties may obtain, copy, use or disclose our technologies and processes. We currently hold more than 3,600 U.S. patents. However, we cannot assure you that any additional patents will be issued. Even if a new patent is issued, the claims allowed may not be sufficiently broad to protect our technology. In addition, any of our existing or future patents may be challenged, invalidated or circumvented. As such, any rights granted under these patents may not provide us with meaningful protection. We may not have foreign patents or pending applications corresponding to our U.S. patents and applications. Even if foreign patents are granted, effective enforcement in foreign countries may not be available. If our patents do not adequately protect our technology, our competitors may be able to offer products similar to ours. Our competitors may also be able to develop similar technology independently or design around our patents. Some or all of our patents have in the past been licensed and likely will in the future be licensed to certain of our competitors through cross-license agreements.

[Table of Contents](#)

Certain of our software (as well as that of our customers) may be derived from so-called “open source” software that is generally made available to the public by its authors and/or other third parties. Such open source software is often made available to us under licenses, such as the GNU General Public License. These licenses impose certain obligations on us in the event we were to distribute derivative works of the open source software. These obligations may require us to make source code for the derivative works available to the public, and/or license such derivative works under a particular type of license, rather than the forms of license customarily used to protect our intellectual property. While we believe we have complied with our obligations under the various applicable licenses for open source software, in the event the copyright holder of any open source software were to successfully establish in court that we had not complied with the terms of a license for a particular work, we could be required to release the source code of that work to the public and/or stop distribution of that work. With respect to our proprietary software, we generally license such software under terms that prohibit combining it with open source software as described above. Despite these restrictions, parties may combine our proprietary software with open source software without our authorization, in which case we may nonetheless be required to release the source code of our proprietary software.

Our Storage Systems manufacturing facility is subject to disruption. Operations at the Wichita, Kansas manufacturing facility may be disrupted for reasons beyond our control, including work stoppages, fire, earthquake, tornado, floods or other natural disasters, which could have a material adverse effect on our results of operation or financial position.

We depend on third-party subcontractors to assemble, obtain packaging materials for, and test substantially all of our current semiconductor products. If we lose the services of any of our subcontractors or if these subcontractors are unable to obtain sufficient packaging materials, shipments of our products may be disrupted, which could harm our customer relationships and adversely affect our revenues. Third-party subcontractors located in Asia assemble, obtain packaging materials for, and test substantially all of our current semiconductor products. Because we rely on third-party subcontractors to perform these functions, we cannot directly control our product delivery schedules and quality assurance. This lack of control has resulted in the past, and could result in the future, in product shortages or quality assurance problems that could delay shipments of our products or increase our manufacturing, assembly or testing costs.

If our third-party subcontractors are unable to obtain sufficient packaging materials for our products in a timely manner, we may experience a significant product shortage or delay in product shipments, which could seriously harm our customer relationships and materially and adversely affect our net revenues. If any of these subcontractors experiences capacity constraints or financial difficulties, suffers any damage to its facilities, experiences power outages or any other disruption of assembly or testing capacity, we may not be able to obtain alternative assembly and testing services in a timely manner. Due to the amount of time that it usually takes us to qualify assemblers and testers, we could experience significant delays in product shipments if we are required to find alternative assemblers or testers for our components. Any problems that we may encounter with the delivery, quality or cost of our products could damage our customer relationships and materially and adversely affect our results of operations. We are continuing to develop relationships with additional third-party subcontractors to assemble and test our products. However, even if we use these new subcontractors, we will continue to be subject to all of the risks described above.

We depend on third-party subcontractors to manufacture all of our current board products. Third-party subcontractors manufacture all of our current board products. Because we rely on third-party subcontractors to perform this function, we cannot directly control our product delivery schedules and quality assurance. This lack of control has resulted in the past, and could result in the future, in product shortages or quality assurance problems that could delay shipments of our products or increase our manufacturing, assembly or testing costs.

If our third-party subcontractors are unable to manufacture our products in a timely manner, we may experience a significant product shortage or delay in product shipments, which could seriously harm our customer relationships and materially and adversely affect our net sales. If any of these subcontractors experiences capacity constraints or financial difficulties, suffers any damage to its facilities, experiences power outages or encounters any other disruption of manufacturing capacity, we may not be able to obtain alternative manufacturing services in a timely manner. Due to the amount of time that it usually takes us to qualify such third party manufacturers, we could experience significant delays in product shipments if we are required to find alternatives. Any problems that we may encounter with the delivery, quality or cost of our products could damage our customer relationships and materially and adversely affect our results of operations. We are continuing to develop relationships with additional third-party manufacturers for our products. However, even if we use these new subcontractors, we will continue to be subject to all of the risks described above.

We are increasingly exposed to various legal, business, political and economic risks associated with our international operations. We currently obtain a substantial portion of our manufacturing, and all of our assembly and testing services from suppliers located outside the United States. We also frequently ship products to our domestic customers’ international manufacturing divisions

Table of Contents

and subcontractors. We also undertake design and development activities in Canada, China, Dubai, Germany, India, Italy, Russia, Taiwan, and the United Kingdom. We intend to continue to expand our international business activities and to open other design and operational centers abroad. Any geopolitical factors such as terrorist activities, armed conflict or global health conditions, which adversely affect the global economy, may adversely impact our international sales and could make our international operations more expensive. International operations are subject to many other inherent risks, including but not limited to:

- political, social and economic instability;
- exposure to different legal standards, particularly with respect to intellectual property;
- natural disasters and public health emergencies;
- nationalization of business and blocking of cash flows;
- trade and travel restrictions;
- the imposition of governmental controls and restrictions;
- burdens of complying with a variety of foreign laws;
- import and export license requirements and restrictions of the United States and each other country in which we operate;
- unexpected changes in regulatory requirements;
- foreign technical standards;
- changes in tariffs;
- difficulties in staffing and managing international operations;
- fluctuations in currency exchange rates;
- difficulties in collecting receivables from foreign entities or delayed revenue recognition; and
- potentially adverse tax consequences.

Any of the factors described above may have a material adverse effect on our ability to increase or maintain our foreign sales.

We are exposed to fluctuations in foreign currency exchange rates. We have some exposure to fluctuations in foreign currency exchange rates. We have international subsidiaries and distributors that operate and sell our products globally. We routinely hedge these exposures in an effort to minimize the impact of currency fluctuations. However, we may still be adversely affected by changes in foreign currency exchange rates or declining economic conditions in these countries.

We must attract and retain key employees in a highly competitive environment. Our employees are vital to our success and our key management, engineering and other employees are difficult to replace. We do not generally have employment contracts with our key employees. Despite the economic slowdown of the last few years, competition for certain key technical and engineering personnel remains intense. Our continued growth and future operating results will depend upon our ability to attract, hire and retain significant numbers of qualified employees.

The adoption of new accounting standards related to the expensing of stock awards adversely affected our results for the nine months ended October 1, 2006 and is expected to negatively impact the results of operations in subsequent periods. Future changes in financial accounting standards or practices or existing taxation rules or practices may also cause adverse unexpected fluctuations and affect our reported results of operations. On January 1, 2006, we adopted SFAS 123R. In accordance with the modified prospective transition method, we began recognizing compensation expense for all share-based awards on or granted after January 1, 2006, plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made. The adoption of SFAS 123R has a significant impact on our operating results as share-based compensation

expense is charged directly against reported earnings. Numerous judgments and estimates are involved in the calculation of the expense and the changes to those estimates, or different judgments could result in a significant impact on the financial statement.

Financial accounting standards in the United States are constantly under review and may be changed from time to time. Once implemented, these changes could result in material fluctuations in our financial results of operations and/or the way in which such results of operations are reported. Similarly, we are subject to taxation in the United States and a number of foreign jurisdictions. Rates of taxation, definitions of income, exclusions from income, and other tax policies are subject to change over time. Changes in tax laws in a jurisdiction in which we have reporting obligations could have a material impact on our results of operations.

We face uncertainties related to the effectiveness of internal controls. Public companies in the United States are required to review their internal controls over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002. It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will achieve its stated goal under all potential future conditions, regardless of how remote.

Although our management has determined, that our disclosure controls and procedures were effective as of October 1, 2006, we cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent public accounting firm to evaluate our internal controls as ineffective. If our internal controls over financial reporting are not considered adequate, we may experience a loss of public confidence, which could have an adverse effect on our business and our stock price.

Internal control deficiencies or weaknesses that are not yet identified could emerge. Over time we may identify and correct deficiencies or weaknesses in our internal controls and, where and when appropriate, report on the identification and correction of these deficiencies or weaknesses. However, the internal control procedures can provide only reasonable, and not absolute, assurance that deficiencies or weaknesses are identified. Deficiencies or weaknesses that are not yet identified could emerge and the identification and corrections of these deficiencies or weaknesses could have a material impact on the results of operations for us.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On July 28, 2000, our Board of Directors authorized a new stock repurchase program in which up to 5 million shares of the our common stock may be repurchased in the open market from time to time. There is no expiration date for the plan. There are 3.5 million shares available for repurchase under this plan as of October 1, 2006. We did not repurchase any shares during the three months ended October 1, 2006.

Table of Contents

Item 6. Exhibits

- 10.19 LSI Logic Corporation 2003 Equity Incentive Plan, amended and restated as of May 4, 2004.*
- 10.55 Wafer Supply and Test Services Agreement between LSI Logic Corporation and Semiconductor Components Industries, LLC, as of May 16, 2006.+
- 31.1 Certification of the Chief Executive Officer pursuant to Securities and Exchange Act Rules 13a-15(e) and 15d-1(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-1(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

+ Schedules to this exhibit not filed herewith shall be furnished to the SEC upon request. Portions of this exhibit have been omitted pursuant to a request for confidential treatment.

* Denotes management plan or compensatory plan or arrangement.

** Furnished not filed.

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.

LSI LOGIC CORPORATION
(Registrant)

Date: November 10, 2006

By /s/ Bryon Look
Bryon Look
Executive Vice President & Chief Financial Officer

INDEX TO EXHIBITS

- 10.19 LSI Logic Corporation 2003 Equity Incentive Plan, amended and restated as of May 4, 2004.*
- 10.55 Wafer Supply and Test Services Agreement between LSI Logic Corporation and Semiconductor Components Industries, LLC, as of May 16, 2006.+
- 31.1 Certification of the Chief Executive Officer pursuant to Securities and Exchange Act Rules 13a-15(e) and 15d-1(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Securities and Exchange Act Rules 13-15(e) and 15d-1(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

+ Schedules to this exhibit not filed herewith shall be furnished to the SEC upon request. Portions of this exhibit have been omitted pursuant to a request for confidential treatment.

* Denotes management plan or compensatory plan or arrangement.

** Furnished not filed.

LSI LOGIC CORPORATION
2003 EQUITY INCENTIVE PLAN
(Amended and Restated May 5, 2004)

TABLE OF CONTENTS

	<u>Page</u>
SECTION 1 BACKGROUND AND PURPOSE	1
1.1 Background and Effective Date	1
1.2 Purpose of the Plan	1
SECTION 2 DEFINITIONS	1
2.1 "1934 Act"	1
2.2 "Affiliate"	1
2.3 "Award"	1
2.4 "Award Agreement"	1
2.5 "Board" or "Board of Directors"	1
2.6 "Cash Flow"	1
2.7 "Code"	2
2.8 "Committee"	2
2.9 "Company"	2
2.10 "Director"	2
2.11 "Disability"	2
2.12 "Earnings Per Share"	2
2.13 "Employee"	2
2.14 "Exchange Program"	2
2.15 "Exercise Price"	2
2.16 "Fair Market Value"	2
2.17 "Fiscal Year"	2
2.18 "Grant Date"	2
2.19 "Incentive Stock Option"	2
2.20 "Measurement Period"	3
2.21 "Nonemployee Director"	3
2.22 "Nonqualified Stock Option"	3
2.23 "Option"	3
2.24 "Participant"	3
2.25 "Performance Goals"	3
2.26 "Period of Restriction"	3
2.27 "Plan"	3
2.28 "Profit After Tax"	3
2.29 "Profit Before Tax"	3
2.30 "Restricted Stock"	3
2.31 "Restricted Stock Unit"	3
2.32 "Retirement"	4
2.33 "Return on Capital"	4
2.34 "Return on Equity"	4
2.35 "Return on Sales"	4
2.36 "Revenue"	4
2.37 "Rule 16b-3"	4
2.38 "Section 16 Person"	4

TABLE OF CONTENTS
(continued)

	<u>Page</u>
2.39 "Shares"	4
2.40 "Stock Unit"	4
2.41 "Subsidiary"	4
2.42 "Termination of Service"	4
2.43 "Total Shareholder Return"	4
SECTION 3 ADMINISTRATION	5
3.1 The Committee	5
3.2 Authority of the Committee	5
3.3 Delegation by the Committee	5
3.4 Decisions Binding	5
SECTION 4 SHARES SUBJECT TO THE PLAN	5
4.1 Number of Shares	5
4.2 Lapsed Awards	5
4.3 Adjustments in Awards and Authorized Shares	5
SECTION 5 STOCK OPTIONS	6
5.1 Grant of Options	6
5.2 Award Agreement	6
5.3 Exercise Price	6
5.4 Expiration of Options	7
5.5 Exercisability of Options	7
5.6 Payment	7
5.7 Restrictions on Share Transferability	8
5.8 Certain Additional Provisions for Incentive Stock Options	8
SECTION 6 RESTRICTED STOCK	8
6.1 Grant of Restricted Stock	8
6.2 Restricted Stock Agreement	8
6.3 Transferability	9
6.4 Other Restrictions	9
6.5 Removal of Restrictions	9
6.6 Voting Rights	9
6.7 Dividends and Other Distributions	9
6.8 Return of Restricted Stock to Company	9
SECTION 7 RESTRICTED STOCK UNITS	10
7.1 Grant of Restricted Stock Units	10
7.2 Restricted Stock Unit Agreement	10
7.3 Transferability	10
7.4 Other Restrictions	10
7.5 Award Payout	10
7.6 Dividends and Other Distributions	11
7.7 Cancellation	11

TABLE OF CONTENTS
(continued)

	<u>Page</u>
SECTION 8 MISCELLANEOUS	11
8.1 Deferrals	11
8.2 No Effect on Employment or Service	11
8.3 Participation	11
8.4 Indemnification	11
8.5 Successors	11
8.6 Limited Transferability of Awards	12
8.7 Beneficiary Designations	12
8.8 No Rights as Stockholder	12
SECTION 9 AMENDMENT, TERMINATION, AND DURATION	12
9.1 Amendment, Suspension, or Termination	12
9.2 Duration of the Plan	12
SECTION 10 TAX WITHHOLDING	13
10.1 Withholding Requirements	13
10.2 Withholding Arrangements	13
SECTION 11 LEGAL CONSTRUCTION	13
11.1 Gender and Number	13
11.2 Severability	13
11.3 Requirements of Law	13
11.4 Securities Law Compliance	13
11.5 Governing Law	13
11.6 Captions	13

LSI LOGIC CORPORATION
2003 EQUITY INCENTIVE PLAN

SECTION 1
BACKGROUND AND PURPOSE

1.1 Background and Effective Date. The Plan permits the grant of Nonqualified Stock Options, Incentive Stock Options, Restricted Stock and Restricted Stock Units. The Plan was effective as of March 20, 2003, and was amended and restated in May 2004.

1.2 Purpose of the Plan. The Plan is intended to attract, motivate, and retain employees of the Company and its Affiliates. The Plan also is designed to encourage stock ownership by Participants, thereby aligning their interests with those of the Company's shareholders and to permit the payment of compensation that qualifies as performance-based compensation under section 162(m) of the Code.

SECTION 2
DEFINITIONS

The following words and phrases shall have the following meanings unless a different meaning is plainly required by the context:

2.1 "1934 Act" means the Securities Exchange Act of 1934, as amended. Reference to a specific section of the 1934 Act or regulation thereunder shall include such section or regulation, any valid regulation promulgated under such section, and any comparable provision of any future legislation or regulation amending, supplementing or superseding such section or regulation.

2.2 "Affiliate" means any corporation or any other entity (including, but not limited to, partnerships and joint ventures) controlling, controlled by, or under common control with the Company.

2.3 "Award" means, individually or collectively, a grant under the Plan of Nonqualified Stock Options, Incentive Stock Options, Restricted Stock and/or Restricted Stock Units.

2.4 "Award Agreement" means the written agreement setting forth the terms and provisions applicable to each Award granted under the Plan.

2.5 "Board" or "Board of Directors" means the Board of Directors of the Company.

2.6 "Cash Flow" means the Company's or a business unit's sum of Profit After Tax plus depreciation and amortization less capital expenditures plus changes in working capital comprised of accounts receivable, inventories, other current assets, trade accounts payable, accrued expenses, product warranty, advance payments from customers and long-term accrued expenses, determined in accordance with generally acceptable accounting principles.

2.7 "Code" means the Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code or regulation thereunder shall include such section or regulation, any valid regulation promulgated under such section, and any comparable provision of any future legislation or regulation amending, supplementing or superseding such section or regulation.

2.8 "Committee" means the committee appointed by the Board (pursuant to Section 3.1) to administer the Plan.

2.9 "Company" means LSI Logic Corporation, a Delaware corporation, or any successor thereto.

2.10 "Director" means any individual who is a member of the Board of Directors of the Company.

2.11 "Disability" means a permanent and total disability determined in accordance with uniform and nondiscriminatory standards adopted by the Committee from time to time.

2.12 "Earnings Per Share" means the Company's or a business unit's Profit After Tax, divided by a weighted average number of common shares outstanding and dilutive common equivalent shares deemed outstanding, determined in accordance with generally accepted accounting principles.

2.13 "Employee" means any employee of the Company or of an Affiliate, whether such employee is so employed at the time the Plan is adopted or becomes so employed subsequent to the adoption of the Plan.

2.14 "Exchange Program" means a program established by the Committee under which outstanding Awards are amended to provide for a lower Exercise Price or surrendered or cancelled in exchange for (a) Awards with a different Exercise Price, (b) a different type of Award, (c) cash, or (d) a combination of (a), (b) and/or (c).

2.15 "Exercise Price" means the price at which a Share may be purchased by a Participant pursuant to the exercise of an Option.

2.16 "Fair Market Value" means the closing price per Share on the New York Stock Exchange on the relevant date, or if there were no sales on such date, the closing price per Share on the nearest day before the relevant date, as determined by the Committee. Notwithstanding the preceding, for federal, state, and local income tax reporting purposes, fair market value shall be determined by the Committee (or its delegate) in accordance with uniform and nondiscriminatory standards adopted by it from time to time.

2.17 "Fiscal Year" means the fiscal year of the Company.

2.18 "Grant Date" means, with respect to an Award, the date that the Award was granted.

2.19 "Incentive Stock Option" means an Option to purchase Shares that is designated as an Incentive Stock Option and is intended to meet the requirements of Section 422 of the Code.

2.20 "Measurement Period" means the period during which the satisfaction of performance objectives will be measured to earn a payout of Stock Units. As provided in Section 7, such performance objectives may be based on the passage of time, the achievement of target levels of performance, or the occurrence of other events or conditions, as determined by the Committee, in its discretion.

2.21 "Nonemployee Director" means a Director who is an employee of neither the Company nor of any Affiliate.

2.22 "Nonqualified Stock Option" means an option to purchase Shares that is not intended to be an Incentive Stock Option.

2.23 "Option" means an Incentive Stock Option or a Nonqualified Stock Option.

2.24 "Participant" means an Employee or Nonemployee Director who has an outstanding Award.

2.25 "Performance Goals" means the goal(s) (or combined goal(s)) determined by the Committee (in its discretion) to be applicable to a Participant with respect to an Award. As determined by the Committee, the Performance Goals applicable to an Award may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Cash Flow, (b) Earnings per Share, (c) Profit After Tax, and (d) Profit Before Tax, (e) Return on Capital, (f) Return on Equity, (g) Return on Sales, (h) Revenue, (i) Total Shareholder Return. The Performance Goals may differ from Participant to Participant and from Award to Award. Prior to the Determination Date, the Committee shall determine whether any significant element(s) shall be included in or excluded from the calculation of any Performance Goal with respect to any Participants.

2.26 "Period of Restriction" means the period during which the transfer of Shares of Restricted Stock are subject to restrictions and therefore, the Shares are subject to a substantial risk of forfeiture. As provided in Section 6, such restrictions may be based on the passage of time, the achievement of target levels of performance, or the occurrence of other events or conditions, as determined by the Committee, in its discretion.

2.27 "Plan" means the LSI Logic Corporation 2003 Equity Incentive Plan, as set forth in this instrument and as hereafter amended from time to time.

2.28 "Profit After Tax" means the Company's or a business unit's income after taxes, determined in accordance with generally accepted accounting principles.

2.29 "Profit Before Tax" means the Company's or a business unit's income before taxes, determined in accordance with generally accepted accounting principles.

2.30 "Restricted Stock" means an Award granted to a Participant pursuant to Section 6.

2.31 "Restricted Stock Unit" means an Award granted to a Participant pursuant to Section 7.

2.32 “Retirement” means a Termination of Service occurring on or after the earlier of (a) age sixty-five (65), or (b) age fifty-five (55) and the completion of ten (10) years of service with the Company or an Affiliate.

2.33 “Return on Capital” means the Company’s or a business unit’s Profit After Tax divided by Company’s or business unit’s, as applicable, average invested capital, determined in accordance with generally accepted accounting principles.

2.34 “Return on Equity” means the percentage equal to the Company’s Profit After Tax divided by average stockholder’s equity, determined in accordance with generally accepted accounting principles.

2.35 “Return on Sales” means the percentage equal to the Company’s or a business unit’s Profit After Tax, divided by the Company’s or the business unit’s, as applicable, Revenue, determined in accordance with generally accepted accounting principles.

2.36 “Revenue” means the Company’s or business unit’s net sales, determined in accordance with generally accepted accounting principles.

2.37 “Rule 16b-3” means Rule 16b-3 promulgated under the 1934 Act, and any future regulation amending, supplementing or superseding such regulation.

2.38 “Section 16 Person” means a person who, with respect to the Shares, is subject to Section 16 of the 1934 Act.

2.39 “Shares” means the shares of common stock of the Company.

2.40 “Stock Unit” means a bookkeeping entry initially representing any amount equivalent to the Fair Market Value of one Share. Stock Units represent an unfunded and unsecured obligation of the Company.

2.41 “Subsidiary” means any corporation in an unbroken chain of corporations beginning with the Company if each of the corporations other than the last corporation in the unbroken chain then owns stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

2.42 “Termination of Service” means (a) in the case of an Employee, a cessation of the employee-employer relationship between the Employee and the Company or an Affiliate for any reason, including, but not by way of limitation, a termination by resignation, discharge, death, Disability, Retirement, or the disaffiliation of an Affiliate, but excluding any such termination where there is a simultaneous reemployment by the Company or an Affiliate; and (b) in the case of a Nonemployee Director, a cessation of the Director’s service on the Board for any reason, including, but not by way of limitation, a termination by resignation, death, Disability, Retirement or non-reelection to the Board.

2.43 “Total Shareholder Return” means the total return (change in share price plus reinvestment of any dividends) of a Share.

SECTION 3
ADMINISTRATION

3.1 The Committee. The Plan shall be administered by the Committee. The Committee shall consist of not less than two (2) Directors who shall be appointed from time to time by, and shall serve at the pleasure of, the Board of Directors. The Committee shall be comprised solely of Directors who both are (a) "non-employee directors" under Rule 16b-3, and (b) "outside directors" under Section 162(m) of the Code.

3.2 Authority of the Committee. It shall be the duty of the Committee to administer the Plan in accordance with the Plan's provisions. The Committee shall have all powers and discretion necessary or appropriate to administer the Plan and to control its operation, including, but not limited to, the power to (a) determine which Employees (including Employees who also are Directors) shall be granted Awards, (b) prescribe the terms and conditions of the Awards, (c) interpret the Plan and the Awards, (d) adopt such procedures and subplans as are necessary or appropriate to permit participation in the Plan by Employees (including Employees who also are Directors) who are foreign nationals or employed outside of the United States, (e) adopt rules for the administration, interpretation and application of the Plan as are consistent therewith and (f) interpret, amend or revoke any such rules. Notwithstanding any contrary provision of the Plan, the Committee shall not have the authority to implement an Exchange Program without the approval of the Company's stockholders.

3.3 Delegation by the Committee. The Committee, in its sole discretion and on such terms and conditions as it may provide, may delegate all or any part of its authority and powers under the Plan to one or more Directors or officers of the Company; provided, however, that the Committee may not delegate its authority and powers (a) with respect to Section 16 Persons, or (b) in any way which would jeopardize the Plan's qualification under Section 162(m) of the Code or Rule 16b-3.

3.4 Decisions Binding. All determinations and decisions made by the Committee, the Board, and any delegate of the Committee pursuant to the provisions of the Plan shall be final, conclusive, and binding on all persons, and shall be given the maximum deference permitted by law.

SECTION 4
SHARES SUBJECT TO THE PLAN

4.1 Number of Shares. Subject to adjustment as provided in Section 4.3, the total number of Shares available for grant under the Plan shall not exceed 11,000,000. Shares granted under the Plan may be either authorized but unissued Shares or treasury Shares.

4.2 Lapsed Awards. If an Award is cancelled, terminates, expires, or lapses for any reason, any Shares subject to such Award again shall be available to be the subject of an Award, except as determined by the Committee.

4.3 Adjustments in Awards and Authorized Shares. In the event that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-

off, combination, repurchase, or exchange of Shares or other securities of the Company, or other change in the corporate structure of the Company affecting the Shares such that an adjustment is determined by the Committee (in its sole discretion) to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as it may deem equitable, adjust the number and class of Shares and Stock Units that may be delivered under the Plan, the number, class, and price of Shares and Stock Units subject to outstanding Awards, and the numerical limits of Sections 5.1, 6.1 and 7.1. Notwithstanding the preceding, the number of Shares or Stock Units subject to any Award always shall be a whole number.

SECTION 5 STOCK OPTIONS

5.1 Grant of Options. Subject to the terms and provisions of the Plan, Options may be granted to Employees at any time and from time to time as determined by the Committee in its sole discretion. The Committee, in its sole discretion, shall determine the number of Shares subject to each Option, provided that during any Fiscal Year, no Participant shall be granted Options covering more than 2,000,000 Shares. The Committee may grant Incentive Stock Options, Nonqualified Stock Options, or a combination thereof.

5.2 Award Agreement. Each Option shall be evidenced by an Award Agreement that shall specify the Exercise Price, the expiration date of the Option, the number of Shares to which the Option pertains, any conditions to exercise of the Option, and such other terms and conditions as the Committee, in its discretion, shall determine. The Award Agreement shall also specify whether the Option is intended to be an Incentive Stock Option or a Nonqualified Stock Option.

5.3 Exercise Price. Subject to the provisions of this Section 5.3, the Exercise Price for each Option shall be determined by the Committee in its sole discretion.

5.3.1 Nonqualified Stock Options. In the case of a Nonqualified Stock Option, the Exercise Price shall be not less than one hundred percent (100%) of the Fair Market Value of a Share on the Grant Date.

5.3.2 Incentive Stock Options. In the case of an Incentive Stock Option, the Exercise Price shall be not less than one hundred percent (100%) of the Fair Market Value of a Share on the Grant Date; provided, however, that if on the Grant Date, the Employee (together with persons whose stock ownership is attributed to the Employee pursuant to Section 424(d) of the Code) owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or any of its Subsidiaries, the Exercise Price shall be not less than one hundred and ten percent (110%) of the Fair Market Value of a Share on the Grant Date.

5.3.3 Substitute Options. Notwithstanding the provisions of Sections 5.3.1 and 5.3.2, in the event that the Company or an Affiliate consummates a transaction described in Section 424(a) of the Code (e.g., the acquisition of property or stock from an unrelated corporation), persons who become Employees or Nonemployee Directors on account of such transaction may be granted Options in substitution for options granted by their former employer. If such substitute Options are granted, the Committee, in its sole discretion and consistent with Section 424(a) of the

Code, may determine that such substitute Options shall have an exercise price less than one hundred percent (100%) of the Fair Market Value of the Shares on the Grant Date.

5.4 Expiration of Options.

5.4.1 Expiration Dates. Each Option shall terminate no later than the first to occur of the following events:

- (a) The date for termination of the Option set forth in the written Award Agreement; or
- (b) The expiration of seven (7) years from the Grant Date.

5.4.2 Death of Participant. Notwithstanding Section 5.4.1, if a Participant dies prior to the expiration of his or her Options, the Committee, in its discretion, may provide that his or her Options shall be exercisable for up to three (3) years after the date of death.

5.4.3 Committee Discretion. Subject to the limits of Sections 5.4.1 and 5.4.2, the Committee, in its sole discretion, (a) shall provide in each Award Agreement when each Option expires and becomes unexercisable, and (b) may, after an Option is granted, extend the maximum term of the Option (subject to Section 5.8.4 regarding Incentive Stock Options).

5.5 Exercisability of Options. Options granted under the Plan shall be exercisable at such times and be subject to such restrictions and conditions as the Committee shall determine in its sole discretion. After an Option is granted, the Committee, in its sole discretion, may accelerate the exercisability of the Option.

5.6 Payment. Options shall be exercised by the Participant's delivery of a notice of exercise to the Corporate Secretary of the Company (or its designee), setting forth the number of Shares with respect to which the Option is to be exercised, accompanied by full payment for the Shares. The notice shall be given in the form and manner specified by the Company from time to time.

Upon the exercise of any Option, the Exercise Price shall be payable to the Company in full in cash or its equivalent. The Committee, in its sole discretion, also may permit exercise (a) by tendering previously acquired Shares having an aggregate Fair Market Value at the time of exercise equal to the total Exercise Price, or (b) by any other means which the Committee, in its sole discretion, determines to both provide legal consideration for the Shares, and to be consistent with the purposes of the Plan. As soon as practicable after receipt of a written notification of exercise and full payment for the Shares purchased, the Company shall deliver to the Participant (or the Participant's designated broker), Share certificates (which may be in book entry form) representing such Shares.

5.7 Restrictions on Share Transferability. The Committee may impose such restrictions on any Shares acquired pursuant to the exercise of an Option as it may deem advisable, including, but not limited to, restrictions related to applicable federal securities laws, the requirements of any national securities exchange or system upon which Shares are then listed or traded, or any blue sky or state securities laws.

5.8 Certain Additional Provisions for Incentive Stock Options.

5.8.1 Exercisability. The aggregate Fair Market Value (determined on the Grant Date(s)) of the Shares with respect to which Incentive Stock Options are exercisable for the first time by any Employee during any calendar year (under all plans of the Company and its Subsidiaries) shall not exceed \$100,000.

5.8.2 Termination of Service. No Incentive Stock Option may be exercised more than three (3) months after the Participant's Termination of Service for any reason other than Disability or death, unless (a) the Participant dies during such three-month period, and (b) the Award Agreement or the Committee permits later exercise. No Incentive Stock Option may be exercised more than one (1) year after the Participant's Termination of Service on account of Disability, unless (a) the Participant dies during such one-year period, and (b) the Award Agreement or the Committee permit later exercise.

5.8.3 Company and Subsidiaries Only. Incentive Stock Options may be granted only to persons who are employees of the Company or a Subsidiary on the Grant Date.

5.8.4 Expiration. No Incentive Stock Option may be exercised after the expiration of seven (7) years from the Grant Date; provided, however, that if the Option is granted to an Employee who, together with persons whose stock ownership is attributed to the Employee pursuant to Section 424(d) of the Code, owns stock possessing more than 10% of the total combined voting power of all classes of the stock of the Company or any of its Subsidiaries, the Option may not be exercised after the expiration of five (5) years from the Grant Date.

SECTION 6
RESTRICTED STOCK

6.1 Grant of Restricted Stock. Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant shares of Restricted Stock to Employees in such amounts as the Committee, in its sole discretion, shall determine. The Committee, in its sole discretion, shall determine the number of Shares to be granted to each Participant as Restricted Stock, provided that during any Fiscal Year, the sum of the number of Restricted Stock Units and Shares of Restricted Stock granted to any one Participant shall not exceed 500,000 .

6.2 Restricted Stock Agreement. Each Award of Restricted Stock shall be evidenced by an Award Agreement that shall specify the Period of Restriction, the number of Shares granted, and such other terms and conditions as the Committee, in its sole discretion, shall determine. Unless the Committee determines otherwise, shares of Restricted Stock shall be held by the Company as escrow agent until the restrictions on such Shares have lapsed.

6.3 Transferability. Except as provided in this Section 6, shares of Restricted Stock may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the end of the applicable Period of Restriction.

6.4 Other Restrictions. The Committee, in its sole discretion, may impose such other restrictions on shares of Restricted Stock as it may deem advisable or appropriate, in accordance with this Section 6.4.

6.4.1 General Restrictions. The Committee may set restrictions based upon the achievement of specific performance objectives (Company-wide, divisional, or individual), applicable federal or state securities laws, or any other basis determined by the Committee in its discretion.

6.4.2 Section 162(m) Performance Restrictions. For purposes of qualifying grants of Restricted Stock as “performance-based compensation” under Section 162(m) of the Code, the Committee, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Committee on or before the latest date permissible to enable the Restricted Stock to qualify as “performance-based compensation” under Section 162(m) of the Code. In granting Restricted Stock that is intended to qualify under Section 162(m) of the Code, the Committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Restricted Stock under Section 162(m) of the Code (e.g., in determining the Performance Goals).

6.4.3 Legend on Certificates. The Committee, in its discretion, may legend the certificates representing Restricted Stock to give appropriate notice of such restrictions.

6.5 Removal of Restrictions. Except as otherwise provided in this Section 6, Shares of Restricted Stock covered by each Restricted Stock grant made under the Plan shall be released from escrow as soon as practicable after the last day of the Period of Restriction. The Committee, in its discretion, may accelerate the time at which any restrictions shall lapse or be removed. After the restrictions have lapsed, the Participant shall be entitled to have any legend or legends under Section 6.4.3 removed from his or her Share certificate, and the Shares shall be freely transferable by the Participant.

6.6 Voting Rights. During the Period of Restriction, Participants holding Shares of Restricted Stock granted hereunder may exercise full voting rights with respect to those Shares, unless the Committee determines otherwise.

6.7 Dividends and Other Distributions. During the Period of Restriction, Participants holding Shares of Restricted Stock shall be entitled to receive all dividends and other distributions paid with respect to such Shares unless otherwise provided in the Award Agreement. If any such dividends or distributions are paid in Shares, the Shares shall be subject to the same restrictions on transferability and forfeitability as the Shares of Restricted Stock with respect to which they were paid.

6.8 Return of Restricted Stock to Company. On the date set forth in the Award Agreement, the Restricted Stock for which restrictions have not lapsed shall revert to the Company and again shall become available for grant under the Plan.

SECTION 7
RESTRICTED STOCK UNITS

7.1 Grant of Restricted Stock Units. Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant Restricted Stock Units to Employees in such amounts as the Committee, in its sole discretion, shall determine. The Committee, in its sole discretion, shall determine the number of Restricted Stock Units to be granted to each Participant, provided that during any Fiscal Year, the sum of the number of Restricted Stock Units and Shares of Restricted Stock granted to any one Participant shall not exceed 500,000.

7.2 Restricted Stock Unit Agreement. Each Award of Restricted Stock Units shall be evidenced by an Award Agreement that shall specify the Measurement Period, the number of Restricted Stock Units granted, and such other terms and conditions as the Committee, in its sole discretion, shall determine.

7.3 Transferability. Except as provided in this Section 7, Restricted Stock Units may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

7.4 Other Restrictions. The Committee, in its sole discretion, may impose such other restrictions on Restricted Stock Units as it may deem advisable or appropriate, in accordance with this Section 7.4.

7.4.1 General Restrictions. The Committee may set restrictions based upon the achievement of specific performance objectives (Company-wide, divisional, or individual), applicable federal or state securities laws, or any other basis determined by the Committee in its discretion.

7.4.2 Section 162(m) Performance Restrictions. For purposes of qualifying grants of Restricted Stock Units as “performance-based compensation” under Section 162(m) of the Code, the Committee, in its discretion, may set performance objectives based upon the achievement of Performance Goals. The Performance Goals shall be set by the Committee on or before the latest date permissible to enable the Restricted Stock Units to qualify as “performance-based compensation” under Section 162(m) of the Code. In granting Restricted Stock Units that are intended to qualify under Section 162(m) of the Code, the Committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Restricted Stock Units under Section 162(m) of the Code (e.g., in determining the Performance Goals).

7.5 Award Payout. After the applicable Measurement Period has ended, the Participant shall be entitled to receive a payout of the number of Stock Units earned during the Measurement Period.

7.5.1 Earning Restricted Stock Units. An Employee shall earn Stock Units under a Restricted Stock Unit Award by meeting the specified performance objectives. The number of Stock Units earned will depend on the extent to which the performance objectives are met.

7.5.2 Form and Timing of Payment. Except as otherwise provided in this Section 7, payment of earned Stock Units shall be made as soon as practicable after the expiration of the

applicable Measurement Period. The Committee, in its sole discretion, may pay such earned Stock Units in cash, Shares, or a combination thereof.

7.6 Dividends and Other Distributions. During the Measurement Period, Participants holding Restricted Stock Units shall be entitled to be credited with all dividends and other distributions paid with respect to the underlying Shares, unless otherwise provided in the Award Agreement. Such dividends and distributions shall be deemed reinvested in Stock Units, which shall be subject to the same terms and conditions as the underlying Award.

7.7 Cancellation. On the date set forth in the Award Agreement, all unearned Stock Units shall be forfeited to the Company, and again shall be available for grant under the Plan.

SECTION 8 MISCELLANEOUS

8.1 Deferrals. The Committee, in its sole discretion, may permit a Participant to defer receipt of the payment of cash or the delivery of Shares that would otherwise be due to such Participant under an Award. Any such deferral elections shall be subject to such rules and procedures as shall be determined by the Committee in its sole discretion.

8.2 No Effect on Employment or Service. Nothing in the Plan shall interfere with or limit in any way the right of the Company to terminate any Participant's employment or service at any time, with or without cause. For purposes of the Plan, transfer of employment of a Participant between the Company and any one of its Affiliates (or between Affiliates) shall not be deemed a Termination of Service. Employment with the Company and its Affiliates is on an at-will basis only.

8.3 Participation. No Employee shall have the right to be selected to receive an Award under this Plan, or, having been so selected, to be selected to receive a future Award.

8.4 Indemnification. Each person who is or shall have been a member of the Committee, or of the Board, shall be indemnified and held harmless by the Company against and from (a) any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan or any Award Agreement, and (b) from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such claim, action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Certificate of Incorporation or Bylaws, by contract, as a matter of law, or otherwise, or under any power that the Company may have to indemnify them or hold them harmless.

8.5 Successors. All obligations of the Company under the Plan, with respect to Awards granted hereunder, shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business or assets of the Company.

8.6 Limited Transferability of Awards. No Award granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will, by the laws of descent and distribution. All rights with respect to an Award granted to a Participant shall be available during his or her lifetime only to the Participant. Notwithstanding the foregoing, after the Plan becomes effective, the Committee (in its sole discretion) may determine that a Participant may, in a manner specified by the Committee, (a) transfer a Nonqualified Stock Option to a Participant's spouse, former spouse or dependent pursuant to a court-approved domestic relations order which relates to the provision of child support, alimony payments or marital property rights, and (b) transfer a Nonqualified Stock Option by bona fide gift and not for any consideration, to (i) a member or members of the Participant's immediate family, (ii) a trust established for the exclusive benefit of the Participant and/or member(s) of the Participant's immediate family, (iii) a partnership, limited liability company of other entity whose only partners or members are the Participant and/or member(s) of the Participant's immediate family, or (iv) a foundation in which the Participant an/or member(s) of the Participant's immediate family control the management of the foundation's assets. The transferability provisions provided in the preceding sentence shall be effective only if expressly determined by the Committee after the effective date of the Plan.

8.7 Beneficiary Designations. Notwithstanding any contrary provisions of Section 8.6, after the Plan becomes effective, the Committee (in its sole discretion) may determine that a Participant under the Plan may name a beneficiary or beneficiaries to whom any vested but unpaid Award shall be paid in the event of the Participant's death. Each such designation shall revoke all prior designations by the Participant and shall be effective only if given in a form and manner acceptable to the Committee. In the absence of any such designation, any vested benefits remaining unpaid at the Participant's death shall be paid to the Participant's estate and, subject to the terms of the Plan and of the applicable Award Agreement, any unexercised vested Award may be exercised by the administrator or executor of the Participant's estate. The provisions of this Section 8.7 shall be effective only if expressly determined by the Committee after the effective date of the Plan.

8.8 No Rights as Stockholder. Except to the limited extent provided in Sections 6.6 and 6.7, no Participant (nor any beneficiary) shall have any of the rights or privileges of a stockholder of the Company with respect to any Shares issuable pursuant to an Award (or exercise thereof), unless and until certificates representing such Shares shall have been issued, recorded on the records of the Company or its transfer agents or registrars, and delivered to the Participant (or beneficiary).

SECTION 9 AMENDMENT, TERMINATION, AND DURATION

9.1 Amendment, Suspension, or Termination. The Board, in its sole discretion, may amend, suspend or terminate the Plan, or any part thereof, at any time and for any reason. The amendment, suspension, or termination of the Plan shall not, without the consent of the Participant, alter or impair any rights or obligations under any Award theretofore granted to such Participant. No Award may be granted during any period of suspension or after termination of the Plan.

9.2 Duration of the Plan. The Plan shall be effective as of March 20, 2003, and subject to Section 9.1 (regarding the Board's right to amend or terminate the Plan), shall remain in effect thereafter. However, without further stockholder approval, no Incentive Stock Option may be granted under the Plan after March 19, 2013.

SECTION 10
TAX WITHHOLDING

10.1 Withholding Requirements. Prior to the delivery of any Shares or cash pursuant to an Award (or exercise thereof), the Company shall have the power and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, and local taxes (including the Participant's FICA obligation) required to be withheld with respect to such Award (or exercise thereof).

10.2 Withholding Arrangements. The Committee, in its sole discretion and pursuant to such procedures as it may specify from time to time, may permit a Participant to satisfy such tax withholding obligation, in whole or in part by (a) electing to have the Company withhold otherwise deliverable Shares, or (b) delivering to the Company already-owned Shares having a Fair Market Value equal to the minimum amount required to be withheld.

SECTION 11
LEGAL CONSTRUCTION

11.1 Gender and Number. Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine; the plural shall include the singular and the singular shall include the plural.

11.2 Severability. In the event any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

11.3 Requirements of Law. The granting of Awards and the issuance of Shares under the Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.

11.4 Securities Law Compliance. With respect to Section 16 Persons, transactions under this Plan are intended to comply with all applicable conditions of Rule 16b-3. To the extent any provision of the Plan, Award Agreement or action by the Committee fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Committee.

11.5 Governing Law. The Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of California.

11.6 Captions. Captions are provided herein for convenience only, and shall not serve as a basis for interpretation or construction of the Plan.

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

WAFER SUPPLY AND TEST SERVICES AGREEMENT

THIS WAFER SUPPLY AND TEST SERVICES AGREEMENT (the “Agreement”) is entered into as of Effective Date by and between **SEMICONDUCTOR COMPONENTS INDUSTRIES, LLC**, a Delaware limited liability company with its principal place of business at 5005 East McDowell Road, Phoenix, Arizona 85008 (“SCI”), and **LSI LOGIC CORPORATION**, a Delaware corporation with its principal place of business at 1621 Barber Lane, Milpitas, CA 95035 (“LSI”). In this Agreement, LSI and SCI are referred to collectively as the “Parties” and each of them is sometimes referred to individually as a “Party.”

RECITALS

A. SCI and LSI are parties to an Asset Purchase Agreement dated April 5, 2006 (the “Asset Purchase Agreement”) pursuant to which LSI has agreed to cause its and its subsidiaries’ right, title, and interest in and to certain assets associated with LSI’s semiconductor wafer fabrication facilities in Gresham, Oregon to be sold and transferred to SCI and SCI has agreed to acquire the same from LSI and its subsidiaries.

B. LSI and its subsidiaries, including LSI Logic HK Holdings, desire to receive from SCI, and SCI agrees to provide to LSI and its subsidiaries, including LSI Logic HK Holdings, certain wafer supply, test, and related services to be performed by SCI at the semiconductor wafer fabrication facilities in Gresham, Oregon.

AGREEMENT

The Parties, intending to be legally bound, agree as follows:

1. DEFINITIONS. Any capitalized term that is used but not expressly defined in this Agreement will have the same meaning in this Agreement as the meaning (if any) given to such term in the Asset Purchase Agreement. For purposes of this Agreement:

1.1 “Change of Control” means, with respect to a Party (or ON), the occurrence of any of the following events: (a) any consolidation or merger of such Party (or ON) with or into any other entity in which the holders of such Party’s (or ON’s) outstanding shares immediately before such consolidation or merger do not, immediately after such consolidation or merger, retain stock representing a majority of the voting power of the surviving entity or stock representing a majority of the voting power of an entity that wholly owns, directly or indirectly, the surviving entity; (b) the sale, transfer, or assignment of securities of such Party (or ON) representing a majority of the voting power of all of such Party’s (or ON’s) outstanding voting securities to an acquiring party or group, in a single transaction or a series of related transactions; or (c) the sale of all or substantially all of such Party’s (or ON’s) assets. In addition, in the case of SCI, a

“Change of Control” also means and includes any transaction or series of transactions as a result of which ON no longer has the power or authority to control and direct the business or affairs of SCI.

1.2 “COT Wafers” means Wafers designed and/or manufactured in connection with LSI’s customer owned tooling program.

1.3 “Die” means an individual integrated circuit product as fabricated or to be fabricated on a silicon Wafer.

1.4 “Effective Date” means the Closing Date.

1.5 “Gflx™ Process Technology” means the 0.11 micron process technology jointly developed by LSI and TSMC that is commonly referred as the “Gflx” process technology.

1.6 “Hot Lot” means an expedited level of manufacturing Wafer Lots that is considered to be a priority 2 level of processing that results in cycle times shorter than the standard cycle time but longer than the cycle time for Super Hot Lots.

1.7 “In-Process Wafers” has the meaning set forth in Section 2.4.

1.8 “Licensed Material” means all information and materials (including process technology and specifications, recipes and procedures related to the design, manufacture, testing, quality, functionality and performance of the Products or the provision of the Services), owned by LSI (or with respect to the applicable portions of the Gflx Process Technology, licensed to LSI by TSMC) and furnished by LSI to SCI for use in connection with the manufacture of the Products or the performance of the Services, including the Specifications, mutually agreed upon updates and amendments to the foregoing, and the Tooling

1.9 “LSI’s Requirements” means the quantity and type of Products and Services that are actually ordered by LSI or its Subsidiaries pursuant to this Agreement, subject to the limitations on Orders described in Sections 4.1, 4.2, 4.3, and 4.4.

1.10 “Metallization Processing” means the step in the fabrication of a Wafer in which proper interconnection of circuit elements is made.

1.11 “ON” means ON Semiconductor Corporation, a Delaware corporation and SCI’s parent company.

1.12 “On-Time Delivery” means between [*] prior to the LSI requested delivery date and [*] later than LSI’s requested delivery date; provided however, that up to [*] of deliveries in any [*] can be delivered [*] than LSI’s requested delivery date and ON will still be considered to have satisfied its On-Time Delivery obligations.

1.13 “Order” has the meaning set forth in Section 4.6.

1.14 “Products” means semiconductor Wafer products, in Die in Wafer form

("DWF") or Wafers as Ordered by LSI, (a) of the type currently being manufactured at the Gresham Facilities as of the Effective Date, (b) that are capable of being manufactured at the Gresham Facilities based on the Wafer fabrication process technologies for which the Gresham Facilities are currently qualified as of the Effective Date (including LSI's C9, G10, G11, G12, CMOS35, CMOS25, and CMOS18 process technologies and, as set forth in Section 2.6(a) the Gflx™ Process Technology as in intended to be qualified), and includes COT Wafers and RapidChip® Products, and (c) semiconductor Wafer products that are capable of being manufactured at the Gresham Facilities based on Wafer fabrication process technologies for which the Gresham Facilities are qualified after the Effective Date. Any semiconductor Wafer products that SCI agrees to manufacture or process at the Gresham Facilities for LSI or its Subsidiaries during the term of this Agreement will automatically be deemed included in the definition of "Products."

1.15 "Proprietary Rights" means and includes all: (a) rights associated with works of authorship (whether or not registered), including copyrights and mask work rights, (b) patent rights, (c) trade secret rights, and (d) other types of legally recognized rights in intangible assets (other than trademark and service mark rights, trade dress rights, trade name rights, and similar rights) except as may be necessary for SCI to affix certain LSI trademarks on the Products as requested by LSI, and (e) all registrations, renewals, extensions, combinations, divisions, or reissues of, and applications for, any of the rights referred to in clauses (a) through (d) above.

1.16 "Qualified Purchases" means all amounts paid by LSI (or any of LSI's Subsidiaries) for Products or Services under this Agreement, including for purchases of COT Wafers and all amounts paid by LSI for adders, premiums and other charges associated with the SCI's furnishing of Products hereunder, but excluding payments made by LSI to ON or SCI under the Facilities Use Agreement or Transition Services Agreement and payments for Implant Adders. Also excluded are credits for In-Process Wafers, Raw Wafers, Quartz and Targets (per Attachment B-2, paragraph 4.0) at time of Closing. The amount of any such credits will be added back to the TMPA and the QMPA for the applicable quarter at the time the credit is issued. A Qualified Purchase will be deemed to have occurred, and will be counted for purposes of determination of LSI's fulfillment of any QMPA, with respect to Products, upon the earlier of the agreed upon On-Time Delivery date or the initial shipment of the Product in question, regardless of whether a Product may later be rejected or returned, or with respect to Services, upon performance of the Service in question.

1.17 "Quarter" means a LSI fiscal quarter.

1.18 "Quarterly Minimum Purchase Amount" or "QMPA" has the meaning set forth in Section 3.1.

1.19 "RapidChip® Product" means an integrated circuit manufactured using a RapidChip® Slice with the top metal layers applied to the RapidChip® Slice.

1.20 "RapidChip® Slice" means a partially manufactured integrated circuit in which all silicon based layers have been built based on LSI's proprietary RapidChip®

technology but which does not include the top metal layers.

1.21 “Reticles” means the photomasks that are used to manufacture the Products.

1.22 “Revenue Commitment Period” means the period beginning on the Effective Date and ending on (and including) the second anniversary of the Effective Date.

1.23 “Services” means the Wafer sort test services, Wafer processing services, Metallization Processing services, expedited Wafer processing services, engineering services, probe card maintenance services, inventory storage services, quality assurance services, services relating to COT Wafers, and other similar and related services that LSI may from time to time request SCI to perform by means of an Order, purchase order release, or similar document.

1.24 “Specifications” has the meaning set forth in Section 8.1.

1.25 “Subsidiary” of a Party means any other Person of which (or in which) an amount of the voting securities or other voting ownership interests sufficient to elect at least a majority of such other Person’s board of directors or other governing body (or, if there are no voting interests, more than 50% of the equity interests of which) is directly or indirectly owned or controlled by such Party.

1.26 “Super Hot Lot” means an expedited level of manufacturing Wafer Lots that is considered to be a priority 1 level of processing that results in cycle times shorter than the cycle time for Hot Lots.

1.27 “Total Minimum Purchase Amount” or **“TMPA”** has the meaning set forth in Section 3.1.

1.28 “TSMC” means Taiwan Semiconductor Manufacturing Co., Ltd.

1.29 “Wafer” means a crystalline substrate for integrated circuit fabrication which when fully processed may consist of several potential finished Die.

1.30 “Wafer Lot” means a batch or lot of Wafers that are processed at the same time. Each Wafer Lot (or number of Die as converted to Wafers) to be Ordered by LSI and processed by SCI for LSI and its Subsidiaries will consist of a minimum of 24 Wafers, except as otherwise provided in this agreement in Section 5.6(c).

2. SUPPLY OBLIGATION. Using the Gresham Facilities, SCI will manufacture and provide the Products to LSI and perform the Services according to the terms and conditions in this Agreement. It is expressly understood that the quality and performance standards and requirements set forth in this Agreement are intended to represent the operating experience and capability of the Gresham Facilities’ operations as conducted by LSI immediately prior to the Closing (the “Reference Point”). In the event that SCI reasonably and with adequate specificity demonstrates, and so notifies LSI in writing within ninety (90) days after the Reference Point, that the actual operating capability and

performance of the Gresham Facilities' operations as of the Reference Point are inferior to that required for performance to any of such standards or requirements specified herein such that SCI's performance hereunder is adversely impacted to a material extent, at SCI's request the Parties shall in good faith modify such standards or requirements so as to reflect the actual operating capability and performance of the Gresham Facilities' operations as of the Reference Point. It is further understood that for a limited period after the Effective Date SCI will require certain assistance under the Transition Services Agreement. If an issue arises under the Transition Services Agreement that adversely impacts SCI's ability to perform under this Agreement, the parties will discuss in good faith resolution of the issue.

2.1 Products. During the term of this Agreement, subject to the mix limitations in Sections 4.1, 4.2 and 4.3 and the capacity limitations in Section 4.4, SCI will supply LSI with LSI's Requirements for Products. If LSI requests that SCI manufacture and provide to LSI Products that are not of the type manufactured or capable of being manufactured at the Gresham Facilities as of the Effective Date but are capable of being manufactured at the Gresham Facilities as of the date of LSI's request, including but not limited to certain Products LSI procures from [*] in [*], the Parties will mutually agree in writing on the lead times, acceptable yields and defect densities, and other applicable quality and functional requirements and specifications for such products and thereafter such products will automatically be deemed to be Products under this Agreement and the agreed-upon lead times, acceptable yields and defect densities, and other applicable quality and functional requirements and specifications will be deemed to be Specifications under this Agreement. SCI is not required to perform process development work for new technology platforms. The addition of products using processes not being run at the Gresham Facilities as of the Effective Date is subject to mutual agreement. Any process development costs for such additional products will be discussed in good faith between the Parties.

2.2 Wafer Sort Test Services. SCI will perform Wafer sort test services on all applicable Products produced for LSI or its Subsidiaries at the Gresham Facilities and on Products manufactured by a third party for LSI or its Subsidiaries and delivered by LSI or any of its Subsidiaries to SCI for processing by SCI. LSI will provide all necessary test programs to SCI in order to provide the Wafer sort test services.

2.3 Testing by LSI. SCI will allow LSI's test engineers access to and use of the test equipment at the Gresham Facilities during the day shift normal working hours, and such other days and/or times as LSI may reasonably request, under mutually agreeable arrangements and will provide test operator support for LSI's test engineers. The hourly rate for engineering test time will be the same as the rate for production testing. The Parties will establish a mutually agreeable schedule by which LSI's test engineers will have access to and use of such test equipment, updated monthly. If LSI requires additional test time that is not reflected in the applicable schedule, than LSI (in cooperation with SCI) will set priorities between delivery of Products and test time. If unscheduled test time impacts On-time Delivery, then any impacted delivery dates will be appropriately reset so that SCI will not be penalized for failing to deliver in accordance with the original delivery dates.

2.4 In-Process Wafers. SCI will finish processing all Products that are in the process of being fabricated at the Gresham Facilities as of the Effective Date (“In-Process Wafers”) in accordance with LSI’s schedule and requirements for such Products. All In-Process Wafers will remain LSI’s property at all times while at the Gresham Facilities.

2.5 Metallization Processing. LSI will cause its supplier of RapidChip® Slices to deliver quantities thereof to SCI at the Gresham Facilities. SCI will accept deliveries of such RapidChip® Slices and hold them in safekeeping as consigned materials until Metallization Processing is ordered by LSI. Thereupon SCI will perform the Metallization Processing and other Services requested by LSI for RapidChip Products® in accordance with the applicable LSI specifications. In the event it is determined after SCI has commenced Metallization Processing of a Slice that such Slice was defective when received by SCI and SCI has properly performed the Metallization Processing and other Services ordered by LSI for such Slice, SCI shall be entitled to payment for the Metallization Processing and other Services performed by SCI.

2.6 Supported Technologies. At a minimum under this Agreement SCI will support and manufacture Products for LSI using the following technologies:

(a) *Process Technologies.* Subject to Section 14.2 below, for the Initial Term SCI will support the C9, G10, G11, G12, CMOS35, CMOS25, and CMOS18 process technologies and the Gflx™ Process Technology at the Gresham Facilities. In the event the full qualification of the Gflx™ Process Technology has not occurred as of the Effective Date, SCI will support the completion of such qualification in accordance with the requirements of LSI’s qualification plan. A summary of LSI’s Gflx qualification plan requirements is set forth as Attachment J hereto.

(b) *Rapid Chip Manufacturing.* Subject to Section 14.2 below, for the term of this Agreement SCI will support manufacture at the Gresham Facilities of RapidChip® Products using both the G12 process technology and the Gflx™ Process Technology, which includes the following obligations: pre-fabrication of the RapidChip® Slices and storage of RapidChip® Slices in inventory for further processing at a later date, storage of RapidChip® Slices fabricated using the Gflx™ Process Technology by a third party designated by LSI for subsequent Metallization Processing at the Gresham Facilities, and Metallization Processing of the RapidChip® Slices manufactured at the Gresham Facilities or by a such third party pursuant to expedited cycle times and fees as requested by LSI and agreed to by SCI.

(c) *LVR.* When requested by LSI, SCI will use low volume Reticles (LVR) for Wafer processing. Additionally:

(i) *Non-RapidChip Products:* Once a particular Product has an actual history volume totaling [*] for G12 and [*] for Gflx and a forecast of consistent reasonable ongoing volumes for the particular Product, then LSI shall provide a full volume Reticle set. The number of LVRs shall be limited to no more than the average for the [*] prior to the Effective Date.

(ii) *RapidChip Products*: Both SCI and LSI recognize that RapidChip Products will require support of LVR Reticles for Wafer processing. SCI will continue to use LVR Reticles for such RapidChip Products until such time that LSI anticipates there will be consistent and adequate future volumes for any such RapidChip Product, at which time an HVR set will be purchased by LSI. Attachment B-1 has separate pricing for HVR (when used instead of LVR).

(d) *ITAR Flow Procedures*. Subject to Section 14.2 below, for the term of this Agreement SCI, at its cost, will support the ITAR process flow requirements and support LSI's military and aeronautical business (i.e., the manufacture of integrated circuits for military and aeronautical applications) at the Gresham Facilities.

(e) *Experimental Requests*. For the term of this Agreement, SCI will support LSI's requirements for skew lots, DOE and other engineering-related experimental requests by LSI. SCI will support special skews requested by LSI, including combined poly and implant for mixed signal and for opposite process corner comparison (e.g. strong N- /weak-P). The additional cycle time required for processing any such experimental requests shall be incrementally added to the committed cycle times as defined in Attachment C.

(f) *New Designs*. For the term of this Agreement, SCI will accept from LSI and its Subsidiaries Orders for Products based on new designs for prototype production and volume production to be manufactured using any of the process technologies available at the Gresham Facilities. As new Products are included in LSI's Requirements, the pricing for such Products will be based on the pricing for other Products manufactured using the applicable process technology set forth in Attachment B at the time Orders for such Products are placed. LSI may transfer Products, and the associated Reticles for such Products, from the third party's facility in Japan referred to in Section 2.1 above as new designs for manufacturing at the Gresham Facilities. Attachment E sets forth the applicable micro-capacity for Products using such transferred Reticles.

2.7 Second Source. If at any point during the Revenue Commitment Period LSI believes it needs a second source for any Products, LSI will notify SCI of such need and the Parties will discuss the matter in good faith.

2.8 Direct Relationship with Customer. LSI has relationships with certain ARO customers (including certain process flows and the [*]). SCI agrees to continue to support such relationships either by providing the Products and Services to LSI under this Agreement (in which case LSI will continue to have the direct customer relationship with the ARO customers) or until, as soon as reasonably practicable and subject to the agreement of each ARO customer, SCI takes direct customer responsibility for such customers.

3. PURCHASE REQUIREMENTS

3.1 Minimum. Subject to the terms and conditions of this Agreement and provided that SCI fulfills all of its material obligations under this Agreement (including

its material obligations under Sections 2, 4, 7, and 8), LSI will ensure that it and its Subsidiaries collectively make a minimum amount of one hundred ninety-eight million, eight hundred thousand dollars (\$198,800,000) of Qualified Purchases (the "Total Minimum Purchase Amount" or "TMPA") during the Revenue Commitment Period. At the end of the Revenue Commitment Period, the TMPA will be deemed satisfied if LSI and its Subsidiaries have made an aggregate amount of Qualified Purchases at least equal to the TMPA. In addition, during the Revenue Commitment Period LSI will ensure that it and its Subsidiaries make Qualified Purchases in amounts at least equal to the quarterly minimums set forth in Attachment A, as such minimums may be adjusted pursuant to Section 3.2 (the "Quarterly Minimum Purchase Amount" or "QMPA"). All Qualified Purchases placed during a given Quarter will be totaled to determine if the applicable QMPA has been met. All Qualified Purchases made during the Revenue Commitment Period will be totaled to determine if the TMPA has been met. After the Revenue Commitment Period, SCI will continue to supply LSI's Requirements for Products and Services from the Gresham Facilities in accordance with the terms and conditions of this Agreement; provided, however, LSI will no longer have any obligation to make a minimum amount of Qualified Purchases and the TPMA or QPMA will no longer apply.

3.2 Reconciliation of QMPA. At the end of each Quarter during the Revenue Commitment Period, LSI will provide SCI with a written report stating the actual amount of Qualified Purchases made by LSI and its Subsidiaries in that Quarter and the QMPA for that Quarter and any difference between the amount of Qualified Purchases in the applicable Quarter and the QMPA for that Quarter. If the initial and final Quarters are not complete Quarters, the applicable QMPA will be apportioned on the basis of a 13 week Quarter (e.g., if the QMPA for the second Quarter of 2006 is [*] and there are 10 weeks remaining in the second Quarter of 2006 when this Agreement is signed, the QMPA for the second Quarter of 2006 will be reduced by a factor of 10/13 from [*] to [*] and the difference [*] will become the QMPA for the first three weeks of Q2-08).

(a) Excess. If the amount of LSI's and its Subsidiaries' Qualified Purchases during a given Quarter is greater than the QMPA for that Quarter, the amount by which the Qualified Purchases exceeds the applicable QMPA, but only up to [*] of that Quarter's QMPA, will be carried over and added to the amount of Qualified Purchases made by LSI and its Subsidiaries in the next subsequent Quarter as if made in that Quarter and counted toward the QMPA for that Quarter. (See the example set forth in Attachment B-3.)

(b) Shortfall. If the amount of LSI's and its Subsidiaries' Qualified Purchases during a given Quarter is less than the QMPA for that Quarter, LSI will pay to SCI, within 30 days after the end of the Quarter, an amount equal to the portion of the shortfall (if any) that is greater than [*] of that Quarter's QMPA, and the remainder of the shortfall (up to [*] of that Quarter's QMPA) will be added to the QPMA for the next Quarter, resulting in the QMPA for the next Quarter being equal to the amount of the QMPA set forth in Attachment A plus the amount of the shortfall up to [*] of the previous Quarter's QMPA. (See the example set forth in Attachment B-3.)

(c) Reconciliation of TMPA. At the end of the Revenue Commitment Period or the end of the first subsequent Quarter thereafter in the event of a shortfall in

the last Quarter of the Revenue Commitment Period and the applicability of Section 3.2(b) above, the Parties will perform a final reconciliation of the sum of (i) LSI's and its Subsidiaries' total amount of Qualified Purchases during the Revenue Commitment Period and (ii) the total amount of shortfall payments made (or, for the final Quarter, to be made) pursuant to Section 3.2(b) against the TMPA. Except with respect to the extent that LSI's obligation to fulfill any QMPA has been adjusted, deferred or excused pursuant to paragraph (d) below, if such sum, as may have been so adjusted, is less than the TMPA, then the difference will be paid by LSI to SCI within 30 days after the Parties complete such reconciliation.

(d) Adjustments to TMPA and QMPA. LSI's obligation to fulfill the TMPA and any QMPA may be adjusted, deferred or excused pursuant to circumstances as follows:

(i) In the event that during the Revenue Commitment Period, the On-Time Delivery date is not met by SCI, but LSI's customer will still accept a later delivery of the finished version of such Product, LSI, at its sole discretion, may reduce the QMPA for the Quarter in which the Product was to be delivered and increase the QMPA for the Quarter during the Revenue Commitment Period in which the Product is delivered to LSI by the applicable amount. In the event delivery to LSI's customer is delayed beyond the end of the Revenue Commitment Period, the reconciliation of the TMPA and applicable QMPA will include a reduction to such extent.

(ii) In the event that during the Revenue Commitment Period SCI would be more than two weeks late in making an On-Time Delivery ("Late Delivery" solely for purposes of this paragraph (d)) of any Product and the order for the finished version of such Product from LSI's customer has been cancelled, the QMPA will be reduced by the Late Delivery portion of LSI's Order and LSI will use commercially reasonable efforts to place other Orders for an equivalent amount within the Revenue Commitment Period or within two (2) years thereafter. In the event LSI has not placed an order for such equivalent amount before the end of the Revenue Commitment Period, the reconciliation of the TMPA and applicable QMPA will include a reduction to such extent.

(iii) In the event that LSI returns any Product to SCI due to the non-conformity of the Product for which LSI is entitled to a credit or a refund and LSI's customer for the finished version of such Product will accept a replacement finished version of such Product, the purchase price for such replacement Product will not be counted towards the QMPA or TMPA.

(iv) In the event that LSI returns any Product to SCI due to the non-conformity of the Product for which LSI receives a credit or a refund and LSI's customer for the finished version of such Product will not accept a replacement finished version of such Product, LSI will make commercially reasonable efforts to place other Orders for an equivalent amount of such credit or refund within the Revenue Commitment Period or within two (2) years thereafter. LSI's fulfillment of the applicable QMPA when such non-conforming Product was shipped will not be affected in any manner.

4. FORECASTS AND ORDERING

4.1 Forecasts. Beginning on the Effective Date and continuing thereafter on a monthly basis, LSI will provide SCI with a [*] rolling forecast by Wafer starts of LSI's Requirements by process technology for such period (the "Forecast").

(a) The Forecast will be provided by Wednesday in the fourth week of every LSI fiscal month. Subject to LSI's rights to make certain adjustments the [*] of the Forecast will be fixed ("Binding Forecast"). During (i) the [*] of the Forecast LSI shall have the right to adjust the Binding Forecast amounts upwards or downwards by up to [*] of the total number of Wafer starts stated in the Binding Forecast for such [*]; (ii) the [*] of the Binding Forecast LSI shall have the right to adjust the Binding Forecast amounts upwards or downwards by up to [*] of the total number of Wafer starts stated in the Binding Forecast for such [*]; and (iii) the [*] of the Binding Forecast LSI shall have the right to adjust the Binding Forecast amounts upwards or downwards by up to [*] of the total number of Wafer starts stated in the Binding Forecast for such [*]; provided, however, LSI may not make any increases in the Forecast amounts that would exceed the micro-capacity constraints identified in Attachment E or the availability of resources and raw materials necessary to manufacture the Products and perform the Services.

(b) The [*] of the Forecast will not be binding on LSI, will be subject to adjustment at LSI's discretion, and will identify monthly demand for LSI's Requirements for planning purposes only. Once per Quarter the Parties will review the forecasted capacity loadings, and the availability of resources and raw materials to determine what, if any, additional capacity is available in excess of any previous Forecast amount.

(c) In no event does the exercise by LSI of its right to make any of the adjustments provided by (a) or (b) above to the Forecast relieve LSI from its obligations to meet the TMPA and applicable QMPA.

4.2 Process Technology Mix. In addition to LSI's right to increase or decrease the amounts of the Binding Forecast as described in Section 4.1, if LSI requests changes to the process technology mix (i.e., the quantity of Products to be manufactured using each distinct process technology) within the Binding Forecast period, SCI will make reasonable efforts to accommodate the requested changes, taking into consideration available capacity for the relevant process technology and availability of materials. Unless SCI agrees otherwise, the mix of process technologies used to meet LSI's Requirements set forth in the Forecasts will fall within minimum and maximum weekly start rates for each process technology to be agreed upon by the Parties during the forecasting process for Products, and in any event will not exceed the individual micro-capacities of the process technologies referred to in Section 4.4.

4.3 Product Mix. Attachment A, which sets forth LSI's initial estimates made as of the Effective Date regarding the mix of Products and Services to be ordered by LSI during the Revenue Commitment Period also reflects the Parties' minimum assumptions regarding Wafer capacity for LSI's Requirements and the fulfillment of the applicable QMPA and TMPA by LSI. It is acknowledged that in order for LSI to fulfill

its QMPA and TMPA, additional Product run rates will be required, which will be ascertained pursuant to the Forecasts provided by LSI under Section 4.1. The estimates set out in Attachment A are not binding on LSI with respect to any subsequent Forecast or Order for the production of specific Products or Services. LSI has the right to make changes to this estimated mix of Products and Services when it places Orders, provided, however, LSI will remain obligated to fulfill the TMPA and applicable QMPA.

4.4 Capacity. During the Revenue Commitment Period, SCI will ensure that sufficient capacity at the Gresham Facilities is reserved and available at all times to meet LSI's Requirements. After the Revenue Commitment Period, the Parties will meet on a Quarterly basis to determine the maximum capacity of the Gresham Facilities that will be allocated to LSI; *provided, however*, that SCI will make commercially reasonable efforts to allocate (taking into account SCI's other capacity needs at that time on a *pari passu* basis) maximum capacity to LSI that is at least [*] of the average weekly Wafer start capacity actually used by LSI for the Quarter having the highest number of Orders for Wafer starts submitted by LSI out of the previous [*]. (See the example set forth in Attachment B-3.) The process technologies and related mix thereof set forth in an Order will take into consideration, and not exceed, the capacity allocated to LSI as so agreed to by both Parties from time to time, as well as individual micro-capacities of the process technologies and all other capacity limitations agreed to by the Parties in writing. Attachment E sets forth the process technology micro-capacities at the Gresham Facilities as of the Effective Date. Notwithstanding the foregoing, nothing in this Agreement will limit LSI's right to submit Orders for Products that have been discontinued pursuant to Section 14.2. If LSI requests capacity increases that would require additional capital expenditures by SCI, then the Parties will discuss in good faith options for putting in place the additional capacity (e.g., LSI may consign equipment to SCI or if LSI purchases the equipment, then SCI will rebate the depreciation expense (using LSI's applicable useful life) through a reduction to the applicable Wafer or Die price as set forth in Attachment B-1). In the event additional employees would be required to support production of additional LSI demand, SCI will exercise its reasonable best efforts to hire and employ such additional employees to support the increased demand.

4.5 Minimum Supply of Raw Materials. SCI will maintain adequate inventories of raw materials in order to fulfill the volumes as set forth in the Binding Forecasts provided by LSI. SCI will have the right to invoice LSI for SCI's actual purchase cost for any raw substrates that are unique to LSI's specifications purchased by SCI against the Binding Forecasts, which are not required to meet LSI's actual Orders and are not used within [*] of delivery of the substrates to SCI. The foregoing states LSI's entire obligation and SCI's entire remedy with respect to excess raw materials purchased by SCI if LSI fails to place Orders for Products or Services sufficient to meet the Binding Forecast. If conditions occur that will require SCI to enter into long term take or pay type arrangements with suppliers to secure the supply of raw materials, then the Parties will discuss and resolve in good faith the allocation of obligations and risk under such arrangements.

4.6 Purchase Orders. LSI will submit to SCI weekly purchase order releases containing Die demand or Wafer demand instructions that identify the Products, the

quantity of Products and the applicable process technologies for such Products that are to be shipped to LSI, showing the required shipment date, the address for delivery of the completed Products, and any other information applicable to the Products (each such release, an "Order"). All Orders meeting the requirements of Sections 4.2 and 4.3 and consistent with the Binding Forecast and agreed upon cycle times shall be accepted by SCI and confirmed to LSI within [*]. For all Products involving RapidChip® Slices to be delivered to the Gresham Facilities, SCI cannot commit to a delivery date unless such RapidChip® Slices are on-hand or a projected delivery date for the requisite RapidChip® Slices to the Gresham Facility has been provided. The On-Time Delivery date for any such Product will be reset to the extent the RapidChip® Slices are received later than the projected delivery date to the Gresham Facility. All other Orders will be deemed accepted by SCI unless LSI receives a written notice of rejection (stating the reason or reasons for such rejection) within [*] after LSI submitted the Order to SCI. LSI's Subsidiaries will have the right to submit Orders under this Agreement and all such Orders will be counted as if placed by LSI for the purposes of the Qualified Purchases, Binding Forecasts, Forecasts, and all other purchase requirements of LSI. LSI represents that it has the authority to cause its Subsidiaries to place Orders with SCI under this Agreement and to comply with the terms and conditions of this Agreement when placing Orders with SCI, and LSI will cause its Subsidiaries to comply with the terms and conditions of this Agreement when placing Orders with SCI. LSI will order Products in [*] Wafer lot sizes. Die scheduling will be lot sized by LSI prior to placing Orders.

(a) Changes. LSI may, from time to time after submission of an Order, provide written notice to SCI proposing changes to the applicable Order (a "Change Proposal"). Following delivery and receipt of the Change Proposal, the Parties will promptly discuss appropriate modifications to the applicable Order (including any changes in the delivery or production schedule or to the pricing for the Products and Services that are the subject of the Change Proposal). If the Change Proposal postpones delivery of Products or Services identified in the Order and SCI has not begun the manufacture of the applicable Products or performance of the Services, such Change Proposal will be deemed accepted by the Parties and SCI will implement the Change Proposal. If the Change Proposal postpones delivery of Products or Services identified in the Order and SCI has begun manufacture of the applicable Products or performance of the Services, such Change Proposal will be deemed accepted by the Parties and SCI will continue manufacture of the Products or performance of the Services and with respect to the Products, upon completion will hold the completed Products and completed work product with respect to the Services in inventory until the requested delivery date. Similarly, if a Change Proposal requests partial manufacture of a Product, so long as SCI has not manufactured the Product past the point specified in the Change Proposal, such Change Proposal will be deemed accepted by the Parties and SCI will complete partial manufacture of a Product and hold the Product in inventory until needed by LSI. If SCI is required to hold any Products such hold will not exceed [*] or available storage capacity limitations. After [*], SCI will request instructions from LSI (i) to complete production of such Products and ship them as finished Products, (ii) to ship such Products to LSI in their partially processed condition or (iii) to cancel further production of such Products. SCI shall perform in accordance with LSI's instructions and thereafter invoice LSI for the appropriate Wafer price or the charge for partial processing or cancellation as

appropriate in accordance with the terms of this Agreement.

(b) Cancellation. LSI may cancel any Order or a portion thereof without charge, to the extent that the portion being cancelled has not been started. LSI may cancel any Order or portion thereof that has been started, but will be required to pay a cancellation charge to SCI reflecting the percentage of manufacturing completion (see Attachment B-2) of the Products being cancelled multiplied by the applicable price. Any such cancellation charges during the [*] of this Agreement will be credited towards LSI's fulfillment of the TMPA and applicable QMPA when such cancellation charges occur.

4.7 No Adjustment for Defective Products. If LSI cancels all or any part of an Order or returns any Products as permitted under Section 6.1, Section 11.2(c), or Section 15.9, the amount of such cancelled Order or returned Products will be counted toward LSI's fulfillment of the TMPA, the applicable QMPA, and the applicable Binding Forecast.

5. PRICING; PAYMENT; AND DELIVERY

5.1 Product Pricing. Attachment B-1 to this Agreement sets forth the prices for the Wafers based on the applicable process technologies used to manufacture the Product and the prices for the process adders for optional processing steps. The date applicable to such pricing shall be based on the LSI requested delivery date or the actual delivery date, whichever is later. In addition:

(a) For Products for which [*] Wafers within the prior [*] of an Order being placed have been manufactured on a stable process platform, statistical post processing ("SPP") algorithm (if applicable), and sort test program, Die based pricing will be used. An initial list of Products is set forth in Attachment B-6. Such Die based pricing will be determined using the sort yield, or post SPP yields if applicable, for such Product of the most [*] prior to when the Product is to be manufactured as applied to the applicable Wafer pricing for such Product set forth in Attachment B-1. The applicable Die or Wafer pricing to which such post SPP yield data is applied will be pricing applicable to the Quarter in which delivery of the Product to LSI is made. The NDPW used for Die based pricing will be based on section 5.2 below. For Products with [*] Wafers produced, Wafer based pricing will be used until such time that [*] Wafers will have been produced, and thereafter subsequent Orders will be based on Die based pricing. These prices apply to all of LSI's purchases of the applicable Products made during the Revenue Commitment Period. After the Revenue Commitment Period, the Parties will meet on a quarterly basis to review the pricing and to negotiate in good faith, as the case may be, price decreases, as are justified by reference to external Wafer pricing market data (e.g. Selantek), or price increases, as are justified based on unforeseen and substantial cost increases then being generally experienced by semiconductor manufacturers to the extent such cost increases are also reflected in such external market data.

(b) For Products for which LSI requires bumping, Wafer prices as set forth in Attachment B-1 will be used for such Products; provided, however, for bumped Wafer Products for which [*] Wafers have been manufactured, if the actual Die yields for

such Products, (after bump and sort yield or SPP as applicable) is lower than the expected NDPW due to a Wafer processing cause, LSI shall be entitled to a credit for the shortfall in the actual NDPW as compared to the expected NDPW. Similarly, for bumped Wafer Products for which [*] wafers have been manufactured, if the actual Die yields for such Products (after bump and sort yield or SPP as applicable) is higher than the expected NDPW, SCI shall be entitled to invoice LSI for the excess in the actual NDPW as compared to the expected NDPW.

(c) If the actual number of Die manufactured (for Die Orders) or Wafers manufactured (for Wafer Orders) is greater than the actual quantity LSI ordered, SCI will only ship to LSI the number of Products equal to the nearest half or full lot size ordered by rounding up.

(d) If the actual number of Die manufactured (for Die Orders) or Wafers manufactured (for Wafers Orders) is less than the actual quantity LSI ordered, SCI shall promptly notify LSI of such fact. LSI, at its sole discretion, may cancel such Order to the extent of such quantity that would not be delivered in a timely manner and in the event that LSI's cancellation made pursuant to Section 11.2, the Wafer price amount(s) applicable to such cancelled Order quantity will be deemed to be Qualified Purchases. In the event LSI still desires delivery of the full quantity per the Order to be made, SCI will promptly start the appropriate quantity of Wafers for delivery of such Die or Wafer shortfall and expedite the production and delivery of such Wafers to LSI without additional charges.

5.2 Calculation of Product Pricing

(a) *Setting NDPW.* Prices for the Products are based on the actual number of Wafers that satisfy post SPP yield to be agreed upon by the Parties. When [*] Wafers of a Product that satisfy such agreed-upon post SPP yield and have been produced at the Gresham Facilities (including Wafers produced prior to the Effective Date), a "Net Die per Wafer" or "NDPW" yield factor will be established by the Parties based on the average post SPP yield of the applicable Product for the [*] preceding the date the NDPW yield factor is being established. The NDPW yield factor for those Products that as of the Effective Date have had [*] Wafers produced at the Gresham Facilities is set forth in Attachment B. When the [*] Wafers of additional Products have been manufactured, NDPW yield factor for such additional Products will be established and agreed upon by the Parties; Attachment B will be updated accordingly.

(b) *Price per Good Die.* When the NDPW yield factor is established for a Product, the price for each good Die will be determined based upon a formula. The Parties will review and recalculate the NDPW yield factors and the good Die prices for each applicable Product once per Quarter. The following Products, [*], [*] and [*], including any revisions thereof, are an [*]. These Products will be priced based on the post SPP NDPW as of the Effective Date. Once these [*] are complete and LSI's [*] therefor has [*] for these Products, the NDPW will be immediately adjusted based on the [*] Wafers and the Die pricing will be adjusted accordingly. LSI will [*] of the new Die price on these Products. The Parties will review and recalculate the NDPW yield factor and the Die price for all other Products once per quarter. If the NDPW yield factor for a

Product increases as a result of any such quarterly review, a revised price per good Die will promptly be determined for such Product based upon such formula and applied as the new price for all applicable Wafer starts made thereafter. If the increase in the NDPW yield factor at any such review is [*], the revised price per good Die will be calculated so that [*] of the price decrease is shared with SCI (i.e., the price per good Die paid by LSI will be decreased by [*] of the amount it would have decreased based on upon the pricing formula). NDPW yield factor decreases will not result in a price reduction. (See the example set forth in Attachment B-3.)

(c) Changes in Sort Test Programs or SPP Algorithms. Pricing will be adjusted as follows: (i) if LSI makes changes to the sort test program or SPP algorithm for test coverage that results in a reduction in NDPW unrelated to existing manufacturing or process methodologies, the Die pricing will be adjusted accordingly, (ii) if LSI makes changes to the sort test program or SPP algorithm due to customer requirements that result in a reduction in NDPW that is unrelated to existing manufacturing or process methodologies, the Die pricing will be adjusted accordingly, or (iii) if LSI makes changes to the sort test program or SPP algorithm that results in NDPW as a result of changes made to the existing process by SCI after the Effective Date or manufacturing or workmanship issues unrelated to the process as defined on the Effective Date, the Die pricing will not be adjusted. In all cases, SCI will work with LSI to improve yields and take actions to return the yield back to the original NDPW.

(d) Changes in Test Times. If LSI makes any change in a test program that increases or decreases the test times to sort a Product, the applicable Die price will be adjusted upwards or downwards on all Products to which such changed test time is applied.

(e) Low Volume Production. Once volume for any given technology (e.g., C9, G10, G11, G12 or Gflx) drops below [*] Wafers per [*], all Products running on that technology shall revert Wafer pricing.

(f) Die Pricing. If at any time during this Agreement, SCI determines that the administrative time and costs associated with maintaining Die pricing is unduly burdensome, it will notify LSI and the Parties will negotiate a resolution in good faith.

5.3 Wafer Sort Test Services. SCI will perform Wafer sort test services and will provide access to LSI test engineers to the test equipment for the rate per hour of test equipment time for such services set forth in Attachment B-3. If LSI requires additional test time that is not reflected in the schedule agreed to by the Parties, then LSI (in cooperation with SCI) will set priorities between delivery of Products and test time. If unscheduled test time required by LSI impacts On-time Delivery then any impacted delivery dates will be reset so that SCI will not be penalized for failing to deliver in accordance with the original delivery dates.

5.4 In-Process Wafer Pricing. Pricing for In-Process Wafer processing will be based on the type of process and the degree of completion of the Wafer as of the Effective Date. The prices for the various amounts of Wafer processing according to

each process technology for the In-Process Wafers are set forth in Attachments B-1 and B-2.

5.5 Rapid Chip Product Pricing. Pricing for manufacture and processing of RapidChip® Products will be based on the type of process and the degree of processing of the Product that SCI will perform. The prices for the various amounts of Wafer processing according to each process technology for RapidChip® Products are set forth in Attachment B-1.

5.6 Other Fees

(a) Expedited Processing (Hot Lots and Super Hot Lots). LSI will pay SCI the fees set forth on Attachment B-3 for the corresponding expedited processing. To the extent LSI is charged any amounts for expedited partial processing of Products, such amounts will be prorated over the number of processing moves that receive expedited treatment. Expedite fees shall not be charged for any such lot that is not delivered by the SCI committed expedited delivery date.

(b) Prototypes. LSI will be charged the pricing premium set forth on Attachment B-3 for any prototype products that LSI requests SCI to manufacture.

(c) Small Lots. LSI has the right to place “Small Lot” Orders on average over the quarter for [*] of the production lots of Products with a maximum of [*] of production lots started in any given week. For anything above these percentages, LSI will pay a [*] premium over the standard prices paid to SCI for such Products.

(d) A “Small Lot” is a production lot having less than [*] Wafers.

(e) Reticles. If LSI obtains any Reticles from SCI under this Agreement, any fees paid by LSI for such Reticles will include all fees for engineering work related to preparation of the Reticles and all costs of the initial mask preparation. LSI will own all such Reticles, but SCI will retain custody of and the responsibility for safekeeping for such Reticles during the period they are available for use at the Gresham Facilities.

(f) Consumables. LSI will provide to SCI all probe cards and load boards necessary for SCI to manufacture the Products; provided that both Parties agree that all such probe cards and load boards will remain LSI’s property and the probe cards and load boards for Products manufactured at the Gresham Facilities as of the Effective Date are already located at the Gresham Facilities. LSI will be responsible for maintenance and replacement costs for all probe cards used by SCI. Maintenance costs for probe cards will be billed to LSI at [*]. Any other consumables used by SCI in performance of its obligations under this Agreement will be the sole responsibility of SCI, and LSI will not owe SCI any separate amounts for such consumables. SCI will repair or replace any such items that are damaged, lost or otherwise rendered unusable due to any act or omission by SCI while they are in SCI’s custody or control.

(g) Engineering Maintenance Services. Engineering time for engineering maintenance on Retained Equipment, if requested by LSI, will be charged per Attachment B-3.

(h) Transition Services. Transition Services requested by LSI pursuant to Section 14.4 will be provided by SCI at a [*]. LSI will also reimburse SCI for any reasonable out-of-pocket costs incurred by SCI in providing such Transition Services, subject to LSI's prior approval of such costs.

(i) Invoicing and Payment Terms. SCI will submit to LSI invoices for payment of applicable prices or fees for Products and Services after delivery of the applicable Products to LSI or completion of the applicable Services. LSI will pay all undisputed amounts set forth in each properly delivered invoice [*] from the date of the invoice. LSI will promptly provide to SCI notice of any disputed payments and the Parties will negotiate promptly and in good faith to resolve the issue. Payments will be made by wire transfer to the account specified in Attachment G. All payments will be made in U.S. dollars. Until LSI has received full payment of all amounts due under the Final Installment Payment, LSI shall have and at its discretion may exercise a right to offset any and all amounts otherwise payable pursuant to this Agreement against payment due to LSI pursuant to the Final Installment Payment at any time after the Final Installment Payment, in whole or in part, has become due but remains unpaid.

5.7 Taxes. The prices for the Products and Services are exclusive of sales tax, use tax, value added tax, or other similar tax or duty imposed by any government authority (collectively, "Taxes"). If any such Taxes are imposed in connection with the sale or transfer of Products to LSI or any of its Subsidiaries by SCI hereunder, LSI shall bear the cost of such Taxes provided that the amount of such Taxes is properly invoiced to LSI along with the price of the Products in question. The Parties will cooperate in the recovery of any such Taxes paid and in the reduction of Taxes payable. Without limiting the generality of the foregoing, if LSI provides SCI with a valid reseller's tax exemption certificate for particular Products, SCI will not include any Taxes in its invoices for such Products. In no event will LSI be liable for any taxes based on SCI's net income or profits.

5.8 Inventory. If an Order specifies or LSI requests that SCI store completed or in-process Products in inventory, SCI will keep such Products in an appropriately controlled environment for such Products. SCI shall not be required to provide any such storage in excess of the available storage capacity existing at the Effective Date. Such storage will be at no additional cost to LSI. SCI will retain risk of loss and title to all Products held in inventory by SCI, except as may be otherwise expressly set forth in this Agreement. SCI will invoice LSI for in-process Products held in inventory by SCI only after SCI completes manufacture of the Products and delivers the Products to LSI. LSI will pay such invoices as provided in Section 5.7.

5.9 Delivery. SCI will arrange shipment of the Products to the LSI or the LSI customer facility designated in the Order on the delivery date specified in the Order. All shipments by SCI will be made F.O.B. the Gresham Facilities. SCI will follow LSI's standard packaging, shipping, handling, and insurance procedures for shipment of the

Products. Risk of loss and, except as otherwise provided in this Agreement, title to the Products will pass to LSI (or its Subsidiary) upon delivery of the Products to the common carrier at the Gresham Facilities. LSI will have the right to cancel an Order to the extent of applicable Products that are not shipped within the On-Time Delivery requirements; provided, however, in the event that LSI's cancellation is made pursuant to Section 11.2, the Wafer price amount(s) applicable to such cancelled Order quantity will be deemed to be Qualified Purchases. In addition, SCI will promptly reimburse LSI for any reasonable expedite charges, late charges, or similar costs or expenses incurred by LSI as a result of SCI's failure to meet the On-Time Delivery requirements for any Product, up to a total amount of [*] per Wafer Lot.

5.10 MRB. SCI will manage the MRB process on lots that are placed on any type of factory hold for a process or design related reason. LSI will cooperate with SCI for prompt resolution of the reason such lots were placed on hold. SCI will make commercially reasonable efforts to not allow the distribution of number of MRB lots on sort hold and the average time to resolve them to exceed the results achieved by LSI at the Gresham Facilities for the [*]. The distribution of MRB lots achieved by LSI at the Gresham Facilities in the [*] shall be considered the "Baseline Distribution". To the extent that SCI achieves or exceeds the Baseline Distribution, such MRB lots on sort hold will not be counted in the computation of the On-Time Delivery performance. If the distribution of number of MRB lots on sort hold and the average time are greater than the Baseline Distribution, to the extent the distribution of the quantity of MRB lots on sort hold exceeds the Baseline Distribution, the cycle time that is outside of the Baseline Distribution for such MRB lots will be counted in the computation of the On-Time Delivery performance. Any lot that becomes an MRB lot on hold during Wafer processing (i.e. prior to sort) lot will be counted in the DPML calculation. Lots exempt in this calculation are any lots placed on hold by LSI, including products that are waiting for reticles due to a design change. Notwithstanding the foregoing, any Wafer lot that (i) is in WIP and is an MRB lot as of the Effective Date or (ii) becomes an MRB lot after the Effective Date due to processing that occurred prior to the Effective Date, will not be counted in the DPML calculation or distribution.

6. SCRAP LIMITS

6.1 Minimum Die Yield. If the yield or defect density of the Wafers and/or any Wafer Lot for any Product are at or below the Minimum Die Yield (as defined in Attachment F) for such Product, LSI will have the right to reject the Wafers and/or the entire Wafer Lot, at no cost to LSI. The Minimum Die Yield for each Product will be initially calculated when [*] production Wafers for such Product have been manufactured at the Gresham Facilities (including Wafers manufactured prior to the Effective Date) and will be recalculated every [*] thereafter using the data from the just-ended [*] period; *provided however*, that no reduction in the Minimum Die Yield for a Product will be permitted. Attachment F sets forth the Minimum Die Yield for each Product for which [*] or more production Wafers have been manufactured at the Gresham Facilities as of the Effective Date.

6.2 Rejection of Products. If LSI or one of its Subsidiaries rejects any Products as provided in Section 6.1, SCI will promptly give LSI a full credit for the

amounts paid by LSI for such rejected Products via a credit memo for such rejected Products, including the sort charge value for such rejected Products. If LSI's expected payments to SCI within the [*] would not be fully offset by the credit, at LSI's option, LSI will have the right to require a cash refund equal to the unused amount of the credit.

6.3 Disposal of Scrap. SCI will properly dispose of all Wafers and Wafer Lots rejected by LSI and all other scrap in compliance with all applicable laws in order to prevent any unauthorized sale and environmental hazards; *provided, however*, that SCI will give LSI access as requested by LSI to any scrap material for failure analysis or other engineering purposes.

7. CYCLE TIME REQUIREMENTS

7.1 Cycle Times. SCI will record and report to LSI cycle times for manufacture and supply of the Products in industry-standard days per masking layer ("DPML") by process technology. Promptly after the Effective Date, the Parties will establish cycle times for all process technologies by referencing the cycle times for the applicable Products obtained at the Gresham Facilities during the [*] period ending on the Effective Date. (Attachment C sets forth an example of cycle times.) SCI will measure DPML at the [*] percentile level and not as an average. If for any Product the DPML falls above the [*] percentile level for any measurement period or if during any measurement period there is reasonable evidence to indicate the DPML will be above the [*] percentile level when the relevant measurement for the period is made, SCI will promptly initiate such corrective actions, in coordination with LSI, as LSI reasonably deems appropriate.

7.2 Expedited Production. SCI will allocate to LSI up to [*] Hot Lots and [*] Super Hot Lots in the Gresham Facilities running concurrently at any time. As each Hot Lot or Super Hot Lot, as the case may be, is completed, the available allocated type of Lot will be available to LSI. [*] The subsequent negotiated amounts shall not fall below the Hot Lots or Super Hot Lot percentage of total production as reflected in the allocation for the first half of 2006. SCI will make commercially reasonable efforts to accommodate any additional Hot Lots or Super Hot Lots requested by LSI from time to time. LSI will have the right, in its discretion, to have SCI perform expedited processing for any or all of the process steps in the production of a Wafer Lot.

7.3 Low Running Technologies. Once volumes for any given technology (e.g., C9, C10, G11, G12 or Gflx) falls below [*] Wafers per [*], the applicable cycle time requirement the Parties will mutually agree in good faith to a relaxed DPML.

7.4 [*] Services. For some period of time under this Agreement, [*] services required to complete the processing of the Products may be performed by [*]. The Parties agree that SCI will be responsible for managing the day to day relationship with [*]. Provided SCI has properly performed such activities, SCI will not be responsible for any failure to meet its obligations under this Agreement to the extent resulting from the acts or omissions of [*] If an issue occurs with [*] performance, the Parties agree to discuss in good faith a resolution of the issue.

8. QUALITY, REPORTING, AND INSPECTION

8.1 Quality. Finished Products and Services supplied by SCI hereunder, including RapidChip® Products and In-Process Wafers to the extent processed by SCI, will meet the applicable procedural, quality and functional requirements and specifications (the “Specifications”) as set forth in Attachment H. At all times during this Agreement, SCI will perform in accordance with the requirements specified below.

(a) SCI will manufacture and provide Products to LSI according to the reliability, manufacture, and performance specifications (including monitoring requirements) of LSI.

(b) SCI will comply with the fab related portions of LSI’s corporate quality requirements and procedures as documented by LSI in the following documentation: WG36-000001-00 (Gresham Factory Reliability Requirements Document) and QA00-000004-21 (General Spec for Supplier Quality and Reliability Requirements Guidelines). These requirements and procedures are set forth in Attachment H.

(c) SCI will perform quality inspection on the Products, including Wafer acceptance testing (“WAT”), parametric testing, or E-Test, according to LSI’s specifications, which may include customer-specific enhancements and/or modifications to LSI’s standard specifications.

(d) SCI will maintain the level of quality in production and materials (including gas or chemical) necessary to, at a minimum, satisfy the defect densities and/or quality levels required by LSI or its customers.

(e) SCI will cooperate with LSI to continuously improve all quality metrics and results relating to the supply of Products and Services as LSI and/or LSI’s customers may request.

SCI will be solely responsible for all costs it incurs in meeting the specifications and requirements in this Section 8.1. If SCI desires to make any changes to any of the foregoing requirements or specifications or other changes to the manufacturing process, SCI will follow LSI’s Engineering Change Notification protocols. A copy of the Engineering Change Notification Protocols are set forth in Attachment I.

8.2 Documentation. Within thirty (30) days after the Effective Date, in addition to the Specifications, LSI will document the following processes and specifications:

(a) The specifications and special lead times for the ITAR flow, including the protocols required for the ITAR flow and the Products that will follow the ITAR flow;

(b) The RapidChip® Product protocols, process flows, devices, and special specifications;

(c) The ARO process flows by customer, including the Products and special handling requirements for each customer; and

(d) The work remaining to do with the [*], the resources required, and the cost and the timeline of the [*].

8.3 Reporting. SCI will maintain adequate records and adequate systems to generate all reports and track all data required by LSI. In addition, at a minimum, SCI will give LSI direct systems access to the following data relating to the Products ordered by LSI:

(a) process yield data (fab line yield);

(b) real time access to the work in process (“WIP”) (WIP status by stage, location, quantities, lot number part number and ship dates), substantially similar to what Gresham provides as of the Effective Date;

(c) statistical data (data result type from all tester types of sort, yield maps e-test data and metrology data);

(d) process records (for Lots manufactured for LSI), including in-line inspection data, process travelers and any data, including traceability data, related to the process used for manufacture of LSI’s Products; and

(e) any and all data and reporting statistics required by LSI’s customers on LSI Products. LSI agrees to make all commercially reasonable efforts to work with its customers to limit the scope of such requests to those reasonably obtainable.

The Parties agree that such direct systems access for LSI data will be replaced by “My Fab View” (including number of masking steps left for a particular lot to completion of Wafer processing) and direct access for Product engineering information will continue to be provided through the YDS system.

8.4 Testing by LSI. When LSI receives Products to sort at a location other than the Gresham Facilities, LSI will test the Products according to the applicable Specifications. LSI will provide SCI with LSI’s testing information derived from testing such Products, including the number of good Die, the yield and the defect density for such Products. LSI will report such testing information to SCI [*] after conclusion of LSI’s testing. If LSI’s test results reveal defects that cause LSI to reject any Products, LSI and SCI will cooperate to determine the reason for the defects and resolve the defects in any future Products. LSI has the right to place, access (both directly and remotely), and use a subcontractor technical network server on the test floor of the Gresham Facilities to transfer tester programs and data from testers from SCI’s systems to LSI’s or LSI’s designated subcontractor’s off-site locations. In connection with this server, LSI will have the right to set up and maintain, at LSI’s expense, a communications link to LSI’s off-site locations from the test floor for uploading Wafer sort yield data on the Products that are tested at the Gresham Facilities.

8.5 Process Change Control. SCI will comply with LSI's current procedures for changes to any technology or manufacturing processes under this Agreement. As of the Effective Date, such process change control procedures are set forth in the following specifications: VB00-000356-00 (QRB Operations Spec for Supplier PCN and Change Control) and VB00-000075-00 (QRB Operating Procedure). SCI will notify LSI in writing in advance of all changes to technology or manufacturing processes. In the event LSI makes any changes to such procedures, LSI will provide SCI with reasonable prior written notice.

8.6 Wafer Sort Test Program Revision Control. SCI will use LSI's Wafer sort programs, processes, and procedures for the Products and SCI will have no right to make any changes to such Wafer sort programs, processes, and procedures without the prior written consent of LSI. LSI will update such programs as and when necessary and will promptly provide all such updated programs to SCI. Prior to the commencement of any Wafer sort test services, SCI will verify that it is using the most recent version of the applicable test program. Changes that do not change the sort yield or SPP (if applicable) or the test times, will not require approval from SCI. For all other test program changes, the Parties will define a control process for releasing changes to production.

8.7 Audit and Inspection. Upon reasonable prior written notice from LSI, SCI will allow LSI, its representatives, and/or LSI's customers reasonable access during normal business hours to the Gresham Facilities to audit and inspect the Gresham Facilities (including the equipment), to confirm compliance by SCI with the terms of this Agreement, LSI's quality requirements, and LSI's customer's quality requirements. In addition, SCI will allow LSI and LSI's customers reasonable access to the Gresham Facilities to address any performance issues. If LSI or its customer finds a deficiency with the Gresham Facilities or noncompliance with the terms of this Agreement, LSI will provide written notice to SCI of the deficiency or noncompliance and SCI will cure such deficiency or noncompliance within a reasonable period.

8.8 On-Site LSI Staffing. SCI will permit and facilitate the presence of up to [*] LSI employees reasonably acceptable to SCI at the Gresham Facilities to monitor the performance of the manufacturing operations with respect to the Products and Services. Such LSI employees will be given access to any portion of the Gresham Facilities, including the fab areas, as such LSI employees deem appropriate; provided, however, such person(s) would be required to comply with SCI's security, confidentiality and safety procedures. SCI will provide such security and safety procedures to LSI in writing promptly after the Effective Date and will communicate such procedures to the applicable personnel as appropriate. Such persons are invited to attend, and allowed to participate in, as appropriate, SCI's operations reviews and meetings when Product and Service issues are addressed. During the twelve (12) month period immediately following the Effective Date, SCI will provide adequate separate "visitor" office space and communications facilities for such LSI persons. Thereafter, the Parties will review the desirability for continuation of access to such office space and communications facilities.

9. CONFIDENTIALITY. Any disclosure of any confidential information of either Party pursuant to or in connection with this Agreement will be governed by the terms of the Nondisclosure Agreement, as it may be amended from time to time (the "Master

NDA”). LSI’s Confidential Information protected under the Master NDA includes the Licensed Material, Specifications, process technologies used to manufacture the Products, LSI’s quality and testing requirements, all failure analysis information and all pricing information specified in this Agreement.

10. OWNERSHIP

10.1 License to Licensed Material. Subject to the terms and conditions of this Agreement, LSI hereby grants to SCI, for the term of this Agreement as set forth in Section 14.1, a non-exclusive, royalty-free, non-sublicensable, non-transferable (except as part of an assignment of this Agreement under Section 15.1), limited, revocable license, under all of LSI’s applicable Proprietary Rights, to use the Licensed Material solely at the Gresham Facilities and solely as necessary to manufacture the Products for LSI and its Subsidiaries and perform the Services for LSI and its Subsidiaries, in accordance with this Agreement. LSI retains all right, title, and interest in and ownership of all Licensed Material and no other licenses or rights to any Licensed Material or any other Proprietary Rights of LSI, implied or otherwise, are granted to SCI under this Agreement. SCI is solely responsible for all costs and damages to any Licensed Material that occur while such Licensed Material is in SCI’s possession or control. If at any time during this Agreement LSI no longer has the right to license any of the Licensed Material to SCI, LSI will promptly notify SCI and SCI’s license as to such Licensed Material will promptly cease. Thereafter the Parties will promptly discuss and determine any adjustments that need to be made to this Agreement, including each Party’s obligations hereunder, based on the removal of such item of Licensed Material; provided, however, in no event shall SCI be required to thereby incur any new obligation (financial or otherwise) that is materially greater than SCI’s existing obligations hereunder. Promptly after the Effective Date, LSI will deliver to SCI all Licensed Material not already located at the Gresham Facilities or otherwise in SCI’s possession.

10.2 In-Process Wafers. LSI retains all right, title, and interest in and ownership of all In-Process Wafers. In-Process Wafers will be held by SCI on a consignment basis for completion of the applicable Wafer processing by SCI following the Effective Date. SCI will bear the risk of loss of the In-Process Wafers as of the Effective Date until the In-Process Wafers are delivered to LSI as provided in Section 5.9 above.

10.3 RapidChip Products

(a) RapidChip Slices not manufactured by SCI. LSI retains all right, title, and interest in and ownership of all RapidChip® Slices stored at the Gresham Facilities by SCI and all Products partially processed by a third party and provided to SCI for Metallization Processing under this Agreement. All such RapidChip® Slices and partially processed Products will be held by SCI on a consignment basis for completion of the applicable Wafer processing by SCI. SCI will bear the risk of loss of all such RapidChip® Slices and partially processed Products until delivery of such Products to LSI as provided in Section 5.9 above.

(b) RapidChip Slices manufactured by SCI. SCI will own

RapidChip® Slices manufactured by SCI and held for future completion of the applicable processing by SCI. SCI will bear the risk of loss of all such RapidChip® Slices and partially processed Products until delivery of such Products to LSI as provided in Section 5.9 above.

10.4 Reticles. LSI has, will have, and will retain all right, title, and interest in all Reticles. SCI will safeguard and maintain secure custody of the Reticles until LSI requests return of the Reticles or delivery of the Reticles to a third party, at which time SCI will deliver the Reticles at LSI's cost and risk as instructed by LSI. While the Reticles are in SCI's possession or control, SCI will bear the risk of loss of the Reticles. While in SCI's possession or control, SCI will store the Reticles as specified below.

(a) Archived Reticles. Archived Reticles are those which have not been used in the factory for twelve (12) months or longer. Archived Reticles are allowed to be stored in LSI's current off-site Reticle storage facility at LSI's cost and for a period of time which will be determined by LSI.

(b) Inactive Reticles. Inactive Reticles are those which have been used at any time during the previous twelve (12) months, are currently not being used, but are expected to be used during the following twelve (12) month period. SCI will store Inactive Reticles at the Gresham Facilities in an environment of no less than Class 1000 clean room airflow, with required temperature and humidity ambient control.

(c) Active Reticles. Active Reticles are those which are either currently in production, have been recently used for production, or are about to be used for production. SCI will keep Active Reticles on the production floor so that they can be quickly and safely utilized for Wafer processing.

(d) Adjustments. At SCI's request the foregoing time periods may be modified as is appropriate consistent with the available Reticle storage at the Gresham Facilities. It will be SCI's responsibility to retrieve any Reticles stored as archived or inactive Reticles in a timely manner.

11. WARRANTIES

11.1 Absence of Defects

(a) Products. SCI warrants that the Products delivered to LSI or its Subsidiaries (or their respective customers) will be free from defects in material and workmanship and will comply with all applicable Specifications for a period of [*] from the date of delivery to LSI or its Subsidiary (or LSI's or its Subsidiary's customer, if the Product is delivered directly to the customer). SCI's warranty for In-Process Wafers and any Products partially processed by a third party is limited to the actual work completed by SCI. If any Products do not conform to the Specifications or contain defects in material and workmanship, SCI will, at LSI's option, promptly either replace the defective Products or credit LSI for the price paid for such defective Products. If LSI's expected payments to SCI within the next [*] would not be fully offset by the credit, LSI will have the right to require a cash refund equal to the unused amount of the credit. The

warranty in this Section 11.1(a) does not apply to any failure in conformance or defect resulting from damage to the Products that occurs after the risk of loss of such Products has transferred to LSI nor to any failure in conformance or defect to the extent arising as a result of LSI's design nor for any other cause not attributable to defective materials or workmanship or failure to meet Specifications on the part of SCI. This warranty extends to LSI's Subsidiaries. SCI will not accept warranty claims directly from LSI's customers or users of such customers' Products.

(b) Services. SCI warrants that the Services will be performed in a professional and timely manner, in conformance with all applicable processes and Specifications. If any of the Services do not comply with this warranty, upon request of LSI or its Subsidiaries, SCI will promptly reperform the Services such that they do conform, at no additional cost or expense to LSI or its Subsidiaries.

11.2 Reliability Risk / Epidemic Failures. In the event a defect in material or workmanship or failure to meet Specifications is discovered in any Product, including any defect that is not identified by the requisite Product test screens, sort or final testing, and such defect would indicate an unacceptable reliability risk to the performance or expected life of such Product, the Parties will promptly cooperate by doing a failure analysis to ascertain the root cause for such defect. SCI will make all commercially reasonable efforts to implement appropriate manufacturing changes to prevent the reoccurrence of any such defects. For the purposes of this Agreement, "Epidemic Failure" will be deemed to have occurred if more than [*] of any Wafer Lot, shipment, or Order should fail in substantially the same manner. In the case of Epidemic Failure, SCI and LSI will promptly cooperate to resolve the Epidemic Failure and implement the following procedure:

(a) Notice. Within five (5) Business Days after learning of such Epidemic Failure or receipt of notice thereof from LSI, SCI will give LSI an initial written response indicating its plan for diagnosing the problem.

(b) Solution. SCI will exert all commercially reasonable efforts to diagnose the problem and plan a permanent solution and, if necessary, a work-around for temporary use until the solution is implemented. If requested by SCI, LSI will provide reasonable technical assistance to SCI to assist in determining the cause and appropriate corrective actions for the Epidemic Failure. SCI will promptly reimburse LSI for LSI's reasonable costs associated with providing such assistance. SCI and LSI will mutually agree on a plan to resolve the Epidemic Failure.

(c) Effect on Products. LSI and its Subsidiaries will have the option to refuse delivery of affected Products, cancel any outstanding Orders for the affected Product, and/or return for a cash refund all defective Products and any Products that may be susceptible to the Epidemic Failure. In addition, to the extent the Products still exist as stand-alone components, LSI may return to SCI all defective Products and any Products that may be susceptible to the same failure. The amounts for Products paid or that would have been paid by LSI (or a Subsidiary of LSI) pursuant to an Order for which delivery is refused or the Order is cancelled by LSI (or its Subsidiary) pursuant to this Section 11.2 will be deemed to be Qualified Purchases. LSI will use commercially

reasonable efforts to place other Orders for other Products to an equivalent purchase price amount within the Revenue Commitment Period [*].

(d) Costs Relating to Epidemic Failure. SCI will be responsible for all costs incurred in rectifying any Epidemic Failure including for any solutions, recovery plans, recalls, field replacements, and engineering changes.

11.3 Persistent Performance Problems. If at any time LSI believes problems regarding yield, cycle time, defect density, or other performance metrics relating to the Products are persistent or are not being satisfactorily resolved by SCI, LSI will have the right to escalate such issues to SCI senior management for resolution and SCI will promptly cooperate with LSI to resolve such issues.

11.4 Disclaimer of Warranties. THE EXPRESS WARRANTIES IN THIS SECTION 11 ARE IN LIEU OF ALL OTHER WARRANTIES, WHETHER EXPRESS, IMPLIED, OR STATUTORY, REGARDING THE SERVICES AND THE PRODUCTS, INCLUDING ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

12. INDEMNIFICATION

12.1 By LSI. LSI will indemnify and hold harmless SCI and its Subsidiaries from any and all third party claims or suits brought against SCI or any of its Subsidiaries alleging that the manufacture of or sale to LSI or its Subsidiaries of Products, or the provision of Services to LSI or its Subsidiaries, by SCI or its Subsidiaries pursuant to this Agreement infringes or misappropriates such third party's Proprietary Rights, to the extent that such infringement or misappropriation results from either (a) the compliance by SCI or its Subsidiaries with LSI's specifications as set forth in the Licensed Materials, or (b) the use by SCI or its Subsidiaries of the same equipment, materials, manufacturing methods, and process technologies as those used by LSI or its Subsidiaries at the Gresham Facilities immediately prior to the Closing (provided that, with respect to any alleged infringement or misappropriation that occurs [*], SCI must be able to produce pre-existing documentation clearly showing that the equipment, materials, manufacturing methods, and process technologies in question are in fact the same as those used by LSI or its Subsidiaries at the Gresham Facilities immediately prior to the Closing) ("LSI-Related Claims"). LSI will defend at its own expense any action or proceeding against SCI or its Subsidiaries based on such LSI-Related Claims and will pay those costs and damages that are specifically attributable to such LSI-Related Claims that are finally awarded against SCI or its Subsidiaries or agreed to a monetary settlement of such action or proceeding. Notwithstanding the foregoing, LSI will have no obligation under this Section 12.1 or otherwise with respect to any infringement or misappropriation claim based upon (i) a deviation by SCI or its Subsidiaries from any LSI specification set forth in the Licensed Materials to the extent that such deviation results in the alleged infringement or misappropriation, or (ii) compliance with any LSI specification set forth in the Licensed Materials to the extent there was a non-infringing and commercially reasonable way to implement such specification, after LSI shall have notified SCI in writing pursuant to Section 15.6 of this Agreement of such non-infringing way and SCI had a reasonable opportunity to implement such specification. This Section 12.1 states

LSI's entire liability and SCI's sole and exclusive remedy under this Agreement for any infringement or misappropriation claims relating to any Product or Service, any LSI specification, any Licensed Material, or any other information provided by LSI.

12.2 By SCI. SCI will indemnify and hold harmless LSI and its Subsidiaries from any and all third party claims or suits brought against LSI or any of its Subsidiaries (a) alleging that the manufacture of or sale to LSI or its Subsidiaries of Products, or the provision of Services to LSI or its Subsidiaries, by SCI or its Subsidiaries pursuant to this Agreement infringes or misappropriates a third party's Proprietary Rights, to the extent that the alleged infringement or misappropriation results from (i) a deviation by SCI or its Subsidiaries from any LSI specification set forth in the Licensed Materials (ii) compliance with any LSI specification set forth in the Licensed Materials to the extent there was a non-infringing and commercially reasonable way to implement such specification, after LSI shall have notified SCI in writing pursuant to Section 15.6 of this Agreement of such non-infringing way and SCI had a reasonable opportunity to implement such specification., or (iii) the use by SCI or its Subsidiaries of equipment, materials, manufacturing methods, or process technologies that are not the same as those used by LSI or its Subsidiaries at the Gresham Facilities immediately prior to the Closing (except for changes made to any of the foregoing in this clause (iii) in compliance with Section 8.5 above, and, provided that, with respect to any alleged infringement or misappropriation that occurs more than two years after the Closing Date, it will be presumed, unless SCI can produce pre-existing documentation, including by reference to documentation covered by Section 8.5 above, clearly showing otherwise, that the equipment, materials, manufacturing methods, or process technologies in question were not the same as those used by LSI or its Subsidiaries at the Gresham Facilities immediately prior to the Closing), or (b) arising from or relating to any personal injury or death, or property damage, to the extent arising from any actual or alleged defects in or malfunction of the Products due to their manufacturing by SCI (collectively, the "SCI-Related Claims"). SCI will defend at its own expense any action or proceeding based on such SCI-Related claims and will pay those costs and damages that are specifically attributable to such SCI-Related claims that are finally awarded against LSI or any of its Subsidiaries or agreed to in a monetary settlement of such action or proceeding.

12.3 Procedures. As soon as an indemnified Party receives notice or otherwise obtains knowledge of any third-party claim that may give rise to any claim for indemnification hereunder, the indemnified Party will promptly provide the indemnifying Party with written notice describing the third-party claim. The indemnifying Party will have the right, at its election and at its sole expense, to assume the defense of the third-party claim with its own counsel. If the indemnifying Party elects to assume the defense of the third-party claim, then the indemnifying Party's obligations under Section 12.1 or 12.2 above (as applicable) are subject to the conditions that the indemnified Party (and its applicable Subsidiaries and, in the case of SCI, ON):

(a) give the indemnifying Party access to all information in the indemnified Party's control that are reasonably relevant to the third-party claim (except in instances where providing such access could destroy the attorney-client privilege with respect to such information);

(b) not admit any liability with respect to the third-party claim;

(c) allow the indemnifying Party to control the defense and settlement of the claim, and

(d) cooperate with the indemnifying Party, at the indemnifying Party's reasonable request and expense, in defending or settling the claim.

The indemnifying Party will have the exclusive right to settle, compromise, or adjust the indemnified claim with the prior written consent of the indemnified Party (which consent will not be unreasonably withheld). If the indemnifying Party elects not to assume control of the defense of the third-party claim, then the indemnified Party will defend such third-party claim using counsel of its choice and may settle, compromise, or adjust such third-party claim on such terms as the indemnified Party may consider appropriate without the prior written consent of the indemnifying Party. In the event that the indemnifying Party elects not to assume control of the defense of the third party claim, then the indemnifying Party shall be responsible for all costs incurred and damages paid by the indemnified Party as a result of the third party claim. The indemnifying Party will be relieved of its obligations under this Section 12 as a result of the indemnified Party's failure to give such notice or provide such cooperation only if and to the extent that such failure prejudices the indemnifying Party's ability to perform its obligations above.

13. LIMITATIONS OF LIABILITY. EXCEPT WITH RESPECT TO DAMAGES ARISING FROM A BREACH OF SECTION 9 (CONFIDENTIALITY) AND EXCEPT FOR EACH PARTY'S OBLIGATIONS UNDER SECTION 12 (INDEMNIFICATION), IN NO EVENT WILL EITHER PARTY BE LIABLE FOR ANY CONSEQUENTIAL, PUNITIVE, INDIRECT, EXEMPLARY, SPECIAL, OR INCIDENTAL DAMAGES, INCLUDING ANY LOST DATA AND LOST PROFITS, ARISING FROM OR RELATING TO THIS AGREEMENT REGARDLESS OF THE LEGAL THEORY UPON WHICH SUCH DAMAGES ARE CLAIMED AND EVEN IF ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. EXCEPT FOR BREACHES OF SECTION 9 (CONFIDENTIALITY) AND EXCEPT FOR EACH PARTY'S OBLIGATIONS UNDER SECTION 12 (INDEMNIFICATION), EACH PARTY'S TOTAL CUMULATIVE LIABILITY IN CONNECTION WITH THIS AGREEMENT AND THE PRODUCTS, WHETHER IN CONTRACT OR TORT OR OTHERWISE, WILL NOT EXCEED [*] DURING THE [*] PERIOD UNDER THIS AGREEMENT AND [*] UNDER THE [*] PERIOD UNDER THIS AGREEMENT (THE "CAP"). THE APPLICABLE LIABILITY CAP FOR A PARTICULAR CLAIM OR CAUSE OF ACTION WILL BE DETERMINED BY THE PERIOD WHEN THE FIRST PRODUCT(S) UPON WHICH THE CLAIM IS BASED WERE PRODUCED. AFTER THE FIRST [*] OF THE [*] EITHER PARTY MAY PROPOSE A DIFFERENT CAP BASED UPON THE EXPECTED PURCHASE AND SALES VOLUMES OF PRODUCTS AND SERVICES UNDER THIS AGREEMENT FROM THAT POINT ONWARD AND THE OTHER PARTY WILL NEGOTIATE TO AN APPROPRIATE ADJUSTMENT TO THE CAP FOR PROSPECTIVE PERIODS.

14. TERM AND TERMINATION

14.1 Term. The Agreement will commence on the Effective Date and will continue thereafter for a period of six (6) years (“Initial Term”), unless terminated earlier as provided below. After the Initial Term unless terminated earlier as provided below, the Agreement will automatically renew for successive periods of two (2) years unless either Party has provided written notice of non-renewal to the other Party at least six (6) months prior to the date of expiration of the then-current term.

14.2 Discontinuation of Low-Demand Technology. After the [*] with respect to the Gflx™ Process Technology and LSI’s G12 and G11 process technologies, and after the first [*] with respect to any other LSI process technology, SCI then will have the right to notify LSI that SCI intends to discontinue support of the Products for which demand has fallen below certain agreed upon minimum volumes. If SCI, following [*] as stated above, elects to discontinue support for such Products, SCI will provide LSI with prior written notice of [*] and will cooperate with LSI as LSI may request in implementing and fulfilling a last time buy process for LSI’s end of life requirements for such Products during such 24 month notice period.

14.3 Termination

(a) For Breach. Each Party will have the right to terminate this Agreement by sending written notice of termination to the other Party if the other Party (i) materially breaches this Agreement other than as a result of a Force Majeure described in Section 15.9 below and does not cure the breach within sixty (60) days after receiving written notice thereof from the non-breaching Party, or (b) ceases to conduct business or begins winding up its affairs, becomes the subject of proceedings in bankruptcy, enters into an assignment for the benefit of its creditors, or appoints a receiver or trustee or has a receiver or trustee appointed for it.

(b) For Change of Control. LSI will have the right to terminate this Agreement in the event of a Change of Control of SCI or ON if LSI does not consent to such Change of Control (which consent will not be unreasonably withheld).

14.4 Transition Services. Upon expiration or termination of this Agreement for any reason, SCI will cooperate with LSI and at LSI’s request promptly assist LSI in the preparation and execution of a plan to transition the supply of Products and Services to another provider. After the expiration or termination of this Agreement while LSI is transitioning the supply of Products and Services to another provider, SCI will continue to fulfill Orders submitted by LSI, as long as the Gresham Facilities has capacity to fulfill the Orders. SCI will cooperate with LSI and the alternate provider of Products and Services during this transition and will provide information, technology, training, and intellectual property licenses to the alternate provider of the Products and Services as reasonably requested by LSI.

14.5 Effects of Termination. Upon expiration or termination of this Agreement, except for termination for LSI’s breach pursuant to Section 14.3(a) above, SCI will fulfill all Orders placed under this Agreement prior to the effective date of

termination pursuant to all performance requirements of this Agreement with regard to the satisfactory manufacture, quality, reporting, inspection and delivery of Products and Services. Promptly upon expiration or termination of this Agreement, and except as provided below, all licenses granted to SCI hereunder will immediately cease and SCI will promptly return to LSI all Licensed Material or certify in writing to LSI that the Licensed Materials have all been destroyed, except to the extent that SCI is permitted to retain and/or use any portion of the Licensed Materials pursuant to another agreement with LSI. Notwithstanding the foregoing, SCI will have the right to continue to exercise the licenses granted in this Agreement and to use the Licensed Material after the termination or expiration of this Agreement solely for the time period during which SCI continues to manufacture or provide Products or perform Services using such Licensed Material for LSI or any of its Subsidiaries. Sections 1, 9, 10, 11, 12, 13, 14.4, 14.5, 15 will survive expiration or termination of this Agreement for any reason.

15. GENERAL PROVISIONS

15.1 Assignment. Neither Party may assign or transfer, by operation of law or otherwise, any of its rights under this Agreement (including any licenses granted hereunder) or delegate any of its duties under this Agreement to any third party without the other Party's prior written consent. Any attempted assignment or transfer in violation of the foregoing will be void.

(a) Assignment by SCI. Notwithstanding Section 15.1 above, upon the prior written consent of LSI, which consent will not be unreasonably withheld, SCI will have the right to assign this Agreement in connection with a Change of Control of SCI. If LSI does not consent to an assignment of this Agreement in connection with a Change of Control of SCI and elects to terminate this Agreement as provided in Section 14.3(b), SCI will (and will cause the acquiring party to) provide all reasonable support and assistance to LSI for the transition to LSI's designated alternate source of the supply of Products and Services provided to LSI under this Agreement.

(b) Assignment by LSI. Notwithstanding Section 15.1 above, upon written notice to SCI, LSI will have the right to assign this Agreement in connection with a Change of Control of LSI.

15.2 Compliance with Laws. Each Party will be required to comply with all applicable rules and laws in the performance of its responsibilities under the Agreement including those relating to export licenses and regulations, government permits and government authorizations.

15.3 Resolution of Disputes. With respect to any dispute that arises from or relates to this Agreement, the Parties will first attempt to resolve the dispute cooperatively by escalating resolution of the dispute within each Party. If the Parties are unable to resolve the dispute cooperatively, then prior to either Party taking action in a court of law, the Parties will submit the dispute to mandatory mediation with Judicial Arbitration and Mediation Services (JAMS). The Parties will mutually agree on the identity of the mediator who will resolve the dispute. If the Parties are unable to agree on

a mediator, a neutral mediator will be selected by JAMS. Nothing in this Section 15.3 will prevent either Party from seeking injunctive relief.

15.4 Governing Law. This Agreement will be construed in accordance with, and governed in all respects by, the laws of the State of California (without giving effect to principles of conflicts of law).

15.5 Venue and Jurisdiction. If any legal proceeding or other legal action relating to this Agreement is brought or otherwise initiated, the venue therefor will be in the State of California, which will be deemed to be a convenient forum. Each Party hereby expressly and irrevocably consents and submits to the jurisdiction of the state and federal courts in the State of California.

15.6 Notices. Any notice or other communication required or permitted to be delivered to either Party under this Agreement must be in writing and will be deemed properly delivered, given and received when delivered (by hand, by registered mail, by courier or express delivery service, or by facsimile) to the address or facsimile telephone number set forth beneath the name of such Party below (or to such other address or facsimile telephone number as such Party will have specified in a written notice given to the other Party):

if to SCI:

ON Semiconductor Law Department
5005 E. McDowell Road
Phoenix, AZ 85008
Attention: General Counsel
Facsimile: (602) 244-5601

if to LSI:

LSI Logic Corporation
1621 Barber Lane
Milpitas, CA 95035-7451
Attention: General Counsel
Facsimile: (408) 433-6896

15.7 Remedies. Except as provided in Section 4.5 and Section 12.1, the Parties' rights and remedies under this Agreement are cumulative. Each Party acknowledges that any actual or threatened breach of Section 9 (Confidentiality) or Section 10 (Ownership) will constitute immediate, irreparable harm to the nonbreaching Party for which monetary damages would be an inadequate remedy, and that injunctive relief is an appropriate remedy for such breach. If either Party continues to use the Proprietary Rights of the other Party after its right to do so has terminated or expired, the nonbreaching Party will be entitled to immediate injunctive relief without the requirement of posting bond.

15.8 Independent Contractor. Each Party's relationship to the other Party is that of an independent contractor, and neither Party is an agent or partner of the other.

Neither Party will have, and will not represent to any third party that it has, any authority to act on behalf of the other Party.

15.9 Force Majeure. “Force Majeure” means any act, event, or occurrence beyond a Party’s control, despite its reasonable efforts to prevent, avoid, delay, or mitigate such acts, events, or occurrences, which directly impairs such Party’s ability to perform its obligations under this Agreement, including acts of God, fires, floods, storms, landslides, epidemics, lightning, earthquakes, drought, blight, famine, quarantine, blockade, governmental acts or inaction, orders or injunctions, war, insurrection, terrorist activities, and civil strife. A Party will not be liable for any delays in performance of its obligations under this Agreement caused by a Force Majeure. However, if it appears that the Force Majeure will result in a delay in such Party’s performance, the other Party may take whatever steps it deems necessary or appropriate to protect its interests and fulfill its obligations to its customers (including shifting manufacturing of its products to other facilities or sources and in the case of LSI or its Subsidiaries, canceling outstanding Orders for Products), and if it appears the delay will last more than sixty (60) days, the other Party may, at its option, terminate this Agreement by written notice to the Party delayed in its performance. If this Agreement is not terminated as a result of the Force Majeure or otherwise, the affected Party will resume performance of its obligations under this Agreement as soon as reasonably possible, and the rights and obligations of the Parties under this Agreement (including LSI’s obligations under Section 3) will be equitably adjusted as necessary on account of such delay. Notwithstanding the foregoing, if the supply of Products to LSI and its Subsidiaries under this Agreement is interrupted or substantially diminished as a result of a Force Majeure affecting SCI for a period of more than sixty (60) days, LSI will be excused from all further obligations under Section 3.

15.10 Time of Essence. Time is of the essence in this Agreement.

15.11 Public Announcements. Except as may be required by any law, rule, or regulation of any government body, neither Party will (and neither Party will permit any of its advisors, representatives, or affiliates to) issue any press release or make any public statement regarding this Agreement without the other Party’s prior written consent.

15.12 Parties in Interest. Nothing in this Agreement is intended to provide any rights or remedies to any other person or entity other than the Parties and LSI’s Subsidiaries, which are entitled to place Orders and purchase Products and Services under this Agreement.

15.13 Severability. If any provision of this Agreement, or the application of such provision to any person or entity or set of circumstances, is determined to be invalid, unlawful, void, or unenforceable to any extent, the remainder of this Agreement, and the application of such provision to persons, entities or circumstances other than those as to which it is determined to be invalid, unlawful, void, or unenforceable, will not be affected and will continue to be valid and enforceable to the fullest extent permitted by law.

15.14 Entire Agreement. This Agreement, the Asset Purchase Agreement, the Master NDA, and the other Ancillary Agreements set forth the entire understanding of

the Parties and supersede all other agreements and understandings between the Parties relating to the subject matter hereof and thereof.

15.15 Waiver. No failure on the part of either Party to exercise any power, right, privilege, or remedy under this Agreement, and no delay on the part of either Party in exercising any power, right, privilege, or remedy under this Agreement, will operate as a waiver thereof; and no single or partial exercise of any such power, right, privilege, or remedy will preclude any other or further exercise thereof or of any other power, right, privilege, or remedy.

15.16 Amendments. This Agreement may not be amended, modified, altered, or supplemented except by means of a written instrument executed on behalf of both Parties.

15.17 Counterparts. This Agreement may be executed in several counterparts, each of which will constitute an original and all of which, when taken together, will constitute one agreement.

15.18 Interpretation of Agreement

(a) Each Party acknowledges that it has participated in the drafting of this Agreement, and any applicable rule of construction to the effect that ambiguities are to be resolved against the drafting Party will not be applied in connection with the construction or interpretation of this Agreement.

(b) Whenever required by the context hereof, the singular number will include the plural, and vice versa; the masculine gender will include the feminine and neuter genders; and the neuter gender will include the masculine and feminine genders.

(c) As used in this Agreement, the words “include” and “including,” and variations thereof, will not be deemed to be terms of limitation, and will be deemed to be followed by the words “without limitation.”

(d) For purposes of this Agreement, the word “will” is equivalent in meaning to the word “shall,” both of which describe an act or forbearance which is mandatory under this Agreement.

(e) Unless the context otherwise requires, references in this Agreement to “Sections” and “Attachments” are intended to refer to Sections of and Attachments to this Agreement.

(f) The bold-faced headings contained in this Agreement are for convenience of reference only, will not be deemed to be a part of this Agreement, and will not be referred to in connection with the construction or interpretation of this Agreement.

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the Effective Date.

LSI LOGIC CORPORATION

By: /s/ Donald J. Esses

Name: Donald J. Esses

Title: Exec. V.P., Operations

**SEMICONDUCTOR COMPONENTS INDUSTRIES,
LLC**

By: /s/ Donald A. Colvin

Name: Donald A. Colvin

Title: Chief Financial Officer

List of Attachments

<u>Section Reference</u>	<u>Exhibit</u>	<u>Title</u>
3.1 / 3.1(b)	A	QMPA & TMPA
4.3	A	Estimates of prod mix
5.1	B	(See Sub-schedules)
5.1	B-1	Wafer Pricing
5.4	B-2	In process pricing
5.3 / 5.6	B-3	Additional pricing terms
3.2(a) / (b)	B-4	Example of excess/short
5.2(a)	B-5	Example of die pricing/ SPP / bumped wafers
5.1	B-6	List of Products for Die Pricing
7.1	C	Cycle times
	D	Blank
2.6(f) / 4.1(a)	E	Microcapacity
6.1	F	Min die yield (Scrap)
5.6(g)	G	Payment instructions
8.1(b)	H	Corporate quality reqmts
8.1	I	ECN protocols
2.6 (a)	J	Summary of Gflx Qualification Plan

Attachment B-2

(Section 5.4)

Valuing In-process WIP and Raw Wafers

- 1.0 LSI will continue to own the WIP and raw wafers as of the closing date, but will assign that WIP and raw wafers to the new buyer for completion. All Rapid Chip slice inventories remain the property of LSI.
 - 2.0 At the close timing on the day of closing, LSI will take an accounting of all of the work in process (including any lots on hold and engineering wafers) according to the Promis costing system. LSI will also take an accounting of all raw wafers, quartz and targets on hand including inventoried and expensed raw wafers. .
 - 3.0 Each production and prototype lot will be assigned a percentage of completion based on the standard cost for the stages completed over the standard cost for the total stages for that lot through E-test. Engineering wafers will be assigned a standard cost based on their stage of completion in Promis. This percentage of completion will then be applied to the applicable wafer pricing by technology pursuant to Attachment B-1. The resulting calculation will be the in process wafer completion value. The raw wafers, quartz and targets will be valued at cost and that value will be added to the in process wafer completion value.
 - 4.0 SCI will bill LSI for the full value of the sorted Die or Wafers based upon the agreed to pricing in Attachment B-1 for Wafers or the Die pricing as determined by the methodology in Attachment B-5, as applicable. SCI will then give LSI credit for the value resulting from the calculation of the in process wafer completion and raw wafers, quartz and targets in paragraph 3 above. This dollar credit shall be applied in one third increments in months one, two and three of the agreement.
 - 5.0 For any Wafers in sort and not included in the WIP credit calculation at the time of closing, SCI will only bill the reaming sort time needed to complete the sorting of those lots. Any Die in Wafer form at the facility as of the closing date is considered complete and SCI will not bill LSI for these Wafers and will ship to LSI upon request with no charge.
 - 6.0 Any expedite fees will only be paid on in-process lots that go on expedite after the date of closing, and the expedite fee shall be prorated based on the stage of completion at the time of closing.
 - 7.0 If there are lots that are on an expedited status at the time of close, these lots will get charged the prorated expedited amount from close to completion (of steps that are processed as expedites).
 - 8.0 LSI and SCI will work together to ascertain a reasonable value of any ARO wafers that are in process at the time of closing. This value will be a credit to LSI in the first quarter of the Agreement.
-

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment B – 3
(Section 5.3; 5.6)
Additional Pricing Terms

Fees for Expedited Processing:

Super Hot Lot (Priority 1) — [*] regardless of technology (see attached [Attachment C](#) on related DPML cycle times)

Hot Lot (Priority 2) — [*] regardless of technology (see attached [Attachment C](#) on related DPML cycle times)

Above fees will be prorated over the number of processing moves that receive expedited treatment, if the lot is not expedited from start to finish.

If the expedited lot does not meet the SCI committed date, such expedite fees that would customarily be charged would be waived by SCI.

Prototype Pricing Premium. The prototype pricing premium will be [*] of the regular production price for the applicable Product. DPML cycle times for such prototype are set forth in [Attachment C](#).

Wafer Sort and Engineering Test Services: [*] of test equipment on all non-consigned equipment.

Consigned test equipment, including but not limited to the Advantest and the laser repair equipment, fees of [*] of test equipment time will be charged.

Small Lot Charge: All small lots that are started in a given week above the [*] or [*] allowed will be charged at a premium of [*] of the base price (adder)

LVR Pricing Premium: All production lots that are run utilizing the non rapid chip LVR reticle capability will be charged a premium of [*] of the base price (adder) after the [*] (G12) or [*] (Gflx) limit has been reached on a particular product.

Engineering Charges: Engineering time for special requested engineering time (e.g. NRE) will be charged at [*]

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment B-4
(Section 3.2 (a) and (b))
To show application of Carry Over of Excess / Shortfall under

The following are examples of the QMPA, and how to deal with excess / shortage and carry-forward.

Excess:

Per the wafer supply agreement, the following are the revenue commitments by LSI:

QMPA for Q2, 06 [*]

QMPA for Q3, 06 [*]

At the end of Q2, assume the actual revenue was [*] from LSI

Hence, additional revenue from LSI = [*] — [*] = [*]

[*] of [*] = [*]

Because the [*] exceeds the [*], only [*] of additional revenue of Q2 will be used to offset LSI's Q3 commitment.

Hence, LSI's contractual Q3 commitment still would be [*] of which [*] would already have been fulfilled at the commencement of Q3.

Shortfall:

Per the wafer supply agreement, the following are the revenue commitments by LSI:

QMPA for Q2, 06 [*]

QMPA for Q3, 06 [*]

At the end of Q2, assume the actual revenue was [*] from LSI

Hence, shortfall of revenue from LSI = [*] — [*] = [*]

[*] of [*] = \$[*]

Hence, LSI would have to pay, per payment terms, [*] to SCI and the balance of [*] would be added to the Q3 contractual revenue commitment of LSI. The new Q3 revenue commitment would be [*].

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment B-5
(Section 5.2 (a))
Methodology for “price per good die” and bumped wafers

Price per good die (sorted die)

- 1.0 Die based pricing, based on sorted Die, will be used for products which have more than [*] wafers produced by Gresham, including Wafers produced before the “Effective Date”.
 - 2.0 Wafer based pricing is used for products with [*] Wafers.
 - 3.0 For Die based pricing, a NDPW factor is established using the actual mean yields of the nearest [*] months for each product that has [*] Wafers produced.
 - 4.0 The Wafer price for the quarter the product is requested or shipped (whichever is later) is used to calculate the price per good Die or the Wafer pricing whichever is applicable.
 - 5.0 This price is used for invoicing purposes on Product shipped. The actual quantity shipped times the unit price is used for invoicing purposes.
 - 6.0 SCI acknowledges that LSI uses statistical post processing (SPP), whereby some Die, that pass all electrical parameters are still not used for assembly into final products as there is a higher likelihood of encountering reliability failures and a higher DPPM fallout.
 - 7.0 Products which are on SPP as of the “Effective Date”
 - 7.1 LSI will continue using SPP on Products that are currently on SPP as of the Effective Date.
 - 7.2 SCI will invoice LSI for these Die based on “Post SPP based die”.
 - 8.0 Products which are wafer based pricing and on SPP as of the “Effective Date”
 - 8.1 LSI will continue using SPP on products that are currently on SPP as of the Effective Date.
 - 8.2 SCI will invoice LSI for Wafers until the [*] Wafers limit is reached. Wafer pricing used will be based on attachment B-1. Once [*] Wafers have been shipped, SCI will invoice LSI for these die based on “Post-SPP based Die”.
 - 9.0 Products which are on not on SPP as of the “Effective Date” but subsequently are on SPP during the term of the contract
 - 9.1 For the months, the Products are not on SPP, Die based pricing based on sorted good die will be used for invoicing purposes (or Wafer based pricing if [*] Wafers produced for that Product)
 - 9.2 When the Product is switched to SPP by LSI, SCI will invoice LSI for these Die based on “Post SPP based Die”.
-

Attachment D
(intentionally left blank)

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment E
Microcapacities
(Section 2.6 (f) / 4.1 (a))

Attachment E
Gresham Technology Micro-Capacities (Wafer Starts/Week)

Current Factory Micro-Capacity Limitations

<u>Technology</u>	<u>Current Micro-capacity Limit (Wafer Starts/Week)</u>	<u>[*]</u>
G-10/G-11	[*]	[*]
C-9	[*]	[*]
CMOS18	[*]	[*]
G12-5LM	[*]	[*]
Gfk	[*]	[*]
G10 ([*] reticles being transferred)	[*]	[*]

With respect to Attachment H (Section 8.1(b)) LSI Specification: WG36-000001-00, it consists of twenty-five (17) pages.

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment F (continued)
(Section 6.1)
LSI Specification: VB00-000183-00
MAVERICK LOT CONTROL FOR
WORLDWIDE OPERATION
[*]

Attachment G
(Section 5.6 (g))
Payment Instructions
(to be completed prior to Closing)

With respect to Attachment H (Section 8.1(b)) LSI Specification: WG36-000001-00, it consists of twenty-five (25) pages.

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment H
(Section 8.1 (b))
LSI Specification: WG36-000001-00
FACTORY RELIABILITY REQUIREMENTS
DOCUMENT — GRESHAM FAB
[*]

With respect to Attachment H (Section 8.1(b)) LSI Specification: WG36-000001-00, it consists of twenty-five (25) pages.

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment H (continued)
(Section 8.1 (b))
LSI Specification: QA00-000004-21
SUPPLIER QUALITY AND RELIABILITY
REQUIREMENTS (SQRR)
FOUNDRY OPERATION
[*]

With respect to Attachment I (Section 8.1, 8.5) LSI Specification: VB00-000356-00, it consists of thirteen (13) pages. [*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment I
(Section 8.1, 8.5)
LSI Specification: VB00-00035600
FOUNDRY
PROCESS CHANGE NOTIFICATION
(PCN) PROCEDURE
[*]

With respect to Attachment I (Section 8.1, 8.5) LSI Specification: VB00-000356-00, it consists of twenty-five (25) pages. [*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Attachment I (continued)
(Section 8.1, 8.5)
LSI Specification: VB00-000075-00
QUALIFICATION REVIEW BOARD (QRB)
OPERATING PROCEDURE
[*]

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

**Attachment J
(Section 2.6 (a))
Summary of Gflex Qualification Plan**

n **HTOL/Environmental Test Status/Results**

§ [*]:

§ Passing [*]

§ [*]: Passing: [*]

§ [*] Passing all environmental tests [*]

§ FA completed for Logic IFR fails:

§ [*]

§ All units will be retested

[*]

**Attachment J (continued)
(Section 2.6 (a))
Summary of Gflex Qualification Plan**

n **Assumptions:**

n [*]

n [*]

[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]
[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]
[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]
[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]
[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]
[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]	[*]

n Reliability group has agreed to go to QRB after completion of [*]

[*] Portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

n QRB will be scheduled after the completion of [*]

n [*]

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
AS ADOPTED PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Abhijit Y. Talwalkar, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LSI Logic Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2006

By: /s/ Abhijit Y. Talwalkar
Name: Abhijit Y. Talwalkar
Title: President & Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER
AS ADOPTED PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Bryon Look, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LSI Logic Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2006

By: /s/ Bryon Look
Name: Bryon Look
Title: Executive Vice President & Chief Financial Officer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Abhijit Y. Talwalkar, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of LSI Logic Corporation on Form 10-Q for the quarterly period ended October 1, 2006, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of LSI Logic Corporation.

By: /s/ Abhijit Y. Talwalkar

Name: Abhijit Y. Talwalkar

Title: President & Chief Executive Officer

Date: November 10, 2006

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Bryon Look, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of LSI Logic Corporation on Form 10-Q for the quarterly period ended October 1, 2006, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of LSI Logic Corporation.

By: /s/ Bryon Look
Name: Bryon Look
Title: Executive Vice President & Chief Financial Officer
Date: November 10, 2006