

Avago Technologies LTD
Form 10-Q
March 04, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended January 31, 2010

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: 001-34428

Avago Technologies Limited

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: Avago Technologies LTD - Form 10-Q

Singapore
(State or Other Jurisdiction of
Incorporation or Organization)

N/A
(I.R.S. Employer
Identification No.)

1 Yishun Avenue 7

Singapore 768923
(Address of Principal Executive Offices)

N/A
(Zip Code)

(65) 6755-7888

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

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

Large accelerated filer Accelerated filer

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

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

As of February 26, 2010 there were 237,687,764 shares of our ordinary shares, no par value per share, outstanding.

Table of Contents

AVAGO TECHNOLOGIES LIMITED

Quarterly Report on Form 10-Q

For the Quarterly Period Ended January 31, 2010

TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	3
<u>Item 1. Condensed Consolidated Financial Statements - Unaudited</u>	3
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 4. Controls and Procedures</u>	23
<u>PART II - OTHER INFORMATION</u>	24
<u>Item 1. Legal Proceedings</u>	24
<u>Item 1A. Risk Factors</u>	24
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 3. Defaults Upon Senior Securities</u>	44
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	44
<u>Item 5. Other Information</u>	44
<u>Item 6. Exhibits</u>	45
<u>SIGNATURES</u>	46

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements Unaudited
AVAGO TECHNOLOGIES LIMITED****CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED****(in millions, except share amounts)**

	November 1, 2009 (1)	January 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 472	\$ 144
Trade accounts receivable, net	186	203
Inventory	162	166
Other current assets	44	44
Total current assets	864	557
Property, plant and equipment, net	264	254
Goodwill	171	171
Intangible assets, net	647	627
Other long-term assets	24	23
Total assets	\$ 1,970	\$ 1,632
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 154	\$ 160
Employee compensation and benefits	55	46
Accrued interest	25	5
Capital lease obligations - current	2	3
Other current liabilities	33	34
Current portion of long-term debt	364	
Total current liabilities	633	248
Long-term liabilities:		
Long-term debt	230	230
Capital lease obligations - non-current	3	2
Other long-term liabilities	64	65
Total liabilities	930	545
Commitments and contingencies (Note 11)		
Shareholders equity:		
Ordinary shares, no par value; 235,392,897 shares and 236,054,966 shares issued and outstanding on November 1, 2009 and January 31, 2010, respectively	1,393	1,402
Accumulated deficit	(356)	(318)

Edgar Filing: Avago Technologies LTD - Form 10-Q

Accumulated other comprehensive income	3	3
Total shareholders' equity	1,040	1,087
Total liabilities and shareholders' equity	\$ 1,970	\$ 1,632

- (1) Amounts as of November 1, 2009 have been derived from audited financial statements as of that date.
The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED**

(in millions, except per share data)

	Quarter Ended	
	February 1, 2009	January 31, 2010
Net revenue	\$ 368	\$ 456
Costs and expenses:		
Cost of products sold:		
Cost of products sold	204	247
Amortization of intangible assets	15	15
Restructuring charges	6	
Total cost of products sold	225	262
Research and development	62	64
Selling, general and administrative	40	46
Amortization of intangible assets	6	5
Restructuring charges	5	1
Total costs and expenses	338	378
Income from operations	30	78
Interest expense	(18)	(11)
Gain (loss) on extinguishment of debt	1	(24)
Other expense, net	(2)	(1)
Income before income taxes	11	42
Provision for income taxes	5	4
Net income	\$ 6	\$ 38
Net income per share:		
Basic	\$ 0.03	\$ 0.16
Diluted	\$ 0.03	\$ 0.16
Weighted average shares:		
Basic	214	236
Diluted	219	244

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

(in millions)

	Quarter Ended	
	February 1, 2009	January 31, 2010
Cash flows from operating activities:		
Net income	\$ 6	\$ 38
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	41	39
Amortization of debt issuance costs	1	1
(Gain) loss on extinguishment of debt	(1)	8
Loss on disposal of property, plant and equipment		1
Share-based compensation		5
Changes in assets and liabilities:		
Trade accounts receivable		(17)
Inventory	10	(4)
Accounts payable	(5)	5
Employee compensation and benefits	(31)	(9)
Other current assets and current liabilities	(24)	(28)
Other long-term assets and long-term liabilities	(1)	2
Net cash (used in) provided by operating activities	(4)	41
Cash flows from investing activities:		
Purchase of property, plant and equipment	(12)	(9)
Net cash used in investing activities	(12)	(9)
Cash flows from financing activities:		
Issuance of ordinary shares		4
Debt repayments	(2)	(364)
Net cash used in financing activities	(2)	(360)
Net decrease in cash and cash equivalents	(18)	(328)
Cash and cash equivalents at the beginning of period	213	472
Cash and cash equivalents at end of period	\$ 195	\$ 144

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents

AVAGO TECHNOLOGIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Overview and Basis of Presentation

Overview

We are a designer, developer and global supplier of analog semiconductor devices with a focus on III-V based products. We offer products in four primary target markets: wireless communications, wired infrastructure, industrial and automotive electronics, and consumer and computing peripherals. Applications for our products in these target markets include cellular phones, consumer appliances, data networking and telecommunications equipment, enterprise storage and servers, factory automation, displays, optical mice and printers.

Basis of Presentation

Fiscal Periods. We operate on a 52/53-week fiscal year ending on the Sunday closest to October 31. Our fiscal year ends on the Sunday closest to October 31. Our first quarter of fiscal year 2010 ended on January 31, 2010, the second quarter will end on May 2, 2010, the third quarter will end on August 1, 2010 and the fourth quarter will end on October 31, 2010.

Information. The unaudited condensed consolidated financial statements include the accounts of Avago Technologies Limited, or the Company or Avago, and all of our wholly-owned subsidiaries and are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. Intercompany transactions and balances have been eliminated in consolidation.

Interim information presented in the unaudited condensed consolidated financial statements has been prepared by management and, in the opinion of management, includes all adjustments of a normal recurring nature that are necessary for the fair statement of the financial position, results of operations and cash flows for the periods shown, and is in accordance with GAAP. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the fiscal year ended November 1, 2009, or fiscal year 2009, included in Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on December 15, 2009.

The operating results for the quarter ended January 31, 2010 are not necessarily indicative of the results that may be expected for the year ending October 31, 2010, or fiscal year 2010, or for any other future period. The balance sheet as of November 1, 2009 is derived from the audited financial statements as of that date.

Subsequent Events. We consider events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of issuance of these unaudited condensed consolidated financial statements.

Pending Business Combination. During the quarter ended January 31, 2010, we entered into a definitive agreement to acquire certain assets and assume certain liabilities of a China-based company engaged in the manufacture of motion control encoder products for \$8 million in cash.

This transaction is subject to customary closing conditions and is expected to close in the second or third quarter of fiscal year 2010, although there can be no assurance that this transaction will be completed.

Use of estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods.

Concentrations of credit risk and significant customers. Our cash, cash equivalents and accounts receivable are potentially subject to concentration of credit risk. Cash and cash equivalents are placed with financial institutions that management believes are of high credit quality. Our accounts receivable are derived from revenue earned from customers located in the U.S. and internationally. Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising our customer base and their dispersion across many different industries and geographies. We perform ongoing credit evaluations of our customers' financial conditions, and require collateral, such as letters of credit and bank guarantees, in certain circumstances.

Edgar Filing: Avago Technologies LTD - Form 10-Q

We sell our products through our direct sales force and distributors. One customer accounted for 11% of our net accounts receivable balance at November 1, 2009. One customer accounted for 11% of our net accounts receivable balance at January 31, 2010 and also represented 10% of net revenue for the quarter ended January 31, 2010. For the quarter ended February 1, 2009, one customer represented 12% of net revenue.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Concentration of other risks. The semiconductor industry is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. Our financial results are affected by a wide variety of factors, including general economic conditions worldwide, economic conditions specific to the semiconductor industry, the timely implementation of new manufacturing technologies, the ability to safeguard patents and intellectual property in a rapidly evolving market and reliance on assembly and test subcontractors, third-party wafer fabricators and independent distributors. In addition, the semiconductor market has historically been cyclical and subject to significant economic downturns at various times. We are exposed to the risk of obsolescence of our inventory depending on the mix of future business.

Net income (loss) per share. Basic net income (loss) per share is computed by dividing net income (loss) the numerator by the weighted average number of shares outstanding the denominator during the period excluding the dilutive effect of options and other employee plans. Diluted net income (loss) per share gives effect to all potentially dilutive ordinary share equivalents outstanding during the period. In computing diluted net income (loss) per share under the treasury stock method, the average share price for the period is used in determining the number of shares assumed to be purchased from the proceeds of option exercises.

For the quarters ended February 1, 2009 and January 31, 2010, the number of shares assumed to be purchased also considered the amount of unrecognized compensation cost for future service as required under Accounting Standards Codification 718, or ASC 718. Diluted net income per share for quarters ended February 1, 2009 and January 31, 2010 excluded the potentially dilutive effect of weighted average options to purchase less than a million and 4 million ordinary shares, respectively, as their effect was antidilutive.

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented (in millions, except per share data):

	Quarter Ended	
	February 1, 2009	January 31, 2010
Net income (Numerator):		
Net income	\$ 6	\$ 38
Shares (Denominator):		
Basic weighted average ordinary shares outstanding	214	236
Add: Incremental shares for:		
Dilutive effect of share options	5	8
Shares used in diluted computation	219	244
Net income per share:		
Basic	\$ 0.03	\$ 0.16
Diluted	\$ 0.03	\$ 0.16

Warranty. We accrue for the estimated costs of product warranties at the time revenue is recognized. Product warranty costs are estimated based upon our historical experience and specific identification of the products requirements, which may fluctuate based on product mix. Additionally, we accrue for warranty costs associated with occasional or unanticipated product quality issues if a loss is probable and can be reasonably estimated.

The following table summarizes the changes in accrued warranty (in millions):

Edgar Filing: Avago Technologies LTD - Form 10-Q

Balance as of November 1, 2009 - included in other current liabilities	\$ 7
Charged to cost of products sold	5
Utilized	
Balance as of January 31, 2010 - included in other current liabilities	\$ 12

Table of Contents

AVAGO TECHNOLOGIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The changes to accrued warranty for the quarter ended February 1, 2009 were not significant.

During the first quarter of fiscal year 2010, we recorded warranty accruals of \$5 million based on one specific quality issue. See Note 11. Commitments and Contingencies for further details.

Recently Adopted Accounting Guidance

In the first quarter of fiscal year 2010, we adopted the guidance issued by the Financial Accounting Standards Board, or FASB on business combinations, which significantly changes current practices regarding business combinations. Among the more significant changes, the guidance expands the definition of a business and a business combination; requires the acquirer to recognize the assets acquired, liabilities assumed and noncontrolling interests (including goodwill), measured at fair value at the acquisition date; requires acquisition-related expenses and restructuring costs to be recognized separately from the business combination; requires assets acquired and liabilities assumed to be recognized at their acquisition-date fair values with subsequent changes recognized in earnings; and requires in-process research and development to be capitalized at fair value as an indefinite-lived intangible asset. Although the adoption of this guidance changes our accounting treatment for business combinations on a prospective basis and the nature and magnitude of the specific impact depends upon the nature, terms and size of the acquisitions consummated after the effective date, this guidance did not have a material impact on our results of operations and financial position as we did not acquire any businesses during the quarter ended January 31, 2010.

In the first quarter of fiscal year 2010, we adopted the guidance issued by the FASB on noncontrolling interests in consolidated financial statements. This guidance changes the accounting and reporting for minority interests, reporting them as equity separate from the parent entity's equity, as well as requiring expanded disclosures. The adoption of this guidance did not have a material impact on our results of operations and financial position.

In the first quarter of fiscal year 2010, we adopted the guidance issued by the FASB for determination of the useful life of intangible assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under authoritative accounting guidance for goodwill and other intangible assets. Although future transactions involving intangible assets may be affected by this guidance, it did not have a material impact on our results of operations and financial position as we did not acquire any intangible assets during the quarter ended January 31, 2010.

In the first quarter of fiscal year 2010, we adopted new guidance that specifies the way in which fair value measurements should be made for non-financial assets and non-financial liabilities that are not measured and recorded at fair value on a recurring basis, and specifies additional disclosures related to these fair value measurements. The adoption of this new guidance did not have a significant impact on our results of operations and financial position.

Recent Accounting Guidance Not Yet Adopted

In January 2010, the FASB issued updated guidance related to fair value measurements and disclosures, which requires new disclosures about transfers in and out of Levels 1 and 2 fair value measurements and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. The updated guidance also requires fair value measurements disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements for Level 2 and Level 3 fair value measurements. This guidance will be effective for our second quarter of fiscal year 2010, except for the disclosures about purchases, sales, issuances and settlements relating to Level 3 fair value measurements, which will be effective for our fiscal year 2012 and its interim periods. Other than requiring additional disclosures, we believe the adoption of this guidance will not have a significant impact on our results of operations and financial position.

In October 2009, the FASB issued guidance on revenue recognition that addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how the arrangement consideration should be allocated among the separate units of accounting. This guidance will be effective for our fiscal year 2011 with early adoption permitted. The guidance may be applied retrospectively or prospectively for new or materially modified arrangements. We believe the adoption of this guidance will not have a significant impact on our results of operations and financial position.

Edgar Filing: Avago Technologies LTD - Form 10-Q

In October 2009, the FASB issued guidance that modifies the scope of the software revenue recognition guidance to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. This guidance will be effective for our fiscal year 2011 with early adoption permitted. The guidance may be applied retrospectively or prospectively for new or materially modified arrangements. We believe the adoption of this new guidance will not have a significant impact on our results of operations and financial position.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In June 2009, the FASB issued guidance that eliminates the exceptions to consolidating qualifying special-purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This guidance also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the existing provisions. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. We believe the adoption of this new guidance will not have a significant impact on our results of operations and financial position.

In December 2008, the FASB issued guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This guidance requires disclosures surrounding how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies. Additional disclosures include (a) the major categories of plan assets, (b) the inputs and valuation techniques used to measure the fair value of plan assets, (c) the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period and (d) the significant concentrations of risk within plan assets. This guidance does not change the accounting treatment for postretirement benefit plans. This guidance will be effective for us in fiscal year 2010. The adoption of this guidance will change our disclosure about pension plans beginning with our Annual Report on Form 10-K for fiscal year 2010.

2. Inventory

Inventory consists of the following (in millions):

	November 1, 2009	January 31, 2010
Finished goods	\$ 70	\$ 69
Work-in-process	70	72
Raw materials	22	25
Total inventory	\$ 162	\$ 166

3. Goodwill and Intangible Assets

There was no change in goodwill during the quarter ended January 31, 2010.

Amortizable purchased intangibles consist of the following (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Book Value
As of November 1, 2009:			
Purchased technology	\$ 727	\$ (231)	\$ 496
Customer and distributor relationships	249	(99)	150
Other	3	(2)	1
Total	\$ 979	\$ (332)	\$ 647

Edgar Filing: Avago Technologies LTD - Form 10-Q

As of January 31, 2010:

Purchased technology	\$	727	\$	(246)	\$	481
Customer and distributor relationships		249		(104)		145
Other		3		(2)		1
Total	\$	979	\$	(352)	\$	627

Amortization of intangible assets was \$21 million and \$20 million for the quarters ended February 1, 2009 and January 31, 2010, respectively.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Based on the amount of intangible assets subject to amortization at January 31, 2010, the expected amortization expense for each of the next five fiscal years and thereafter is as follows (in millions):

Fiscal Year	Amount
2010 (remainder)	\$ 59
2011	77
2012	76
2013	76
2014	76
2015	75
Thereafter	188
	\$ 627

The weighted average amortization periods remaining by intangible asset category at January 31, 2010 were as follows (in years):

Amortizable intangible assets:	
Purchased technology	10
Customer and distributor relationships	8
Other	24

4. Borrowings

Our borrowings as of November 1, 2009 and January 31, 2010 consist of the following (in millions):

	November 1, 2009	January 31, 2010
Notes:		
10 1/8% senior notes due 2013	\$ 318	\$
Senior floating rate notes due 2013	46	
11 7/8% senior subordinated notes due 2015	230	230
	594	230
Less: Current portion of long-term debt	364	
Long-term debt	\$ 230	\$ 230

Debt Repayments

During the quarter ended January 31, 2010, we redeemed \$318 million in principal amount of the senior fixed rate notes and \$46 million in principal amount of the senior floating rate notes. We redeemed the senior fixed rate notes and senior floating rate notes at 5.063% premium of the principal amount and no premium, respectively, plus accrued interest, resulting in a loss on extinguishment of debt of \$24 million, which consisted of \$16 million premium and an \$8 million write-off of debt issuance costs and other related expenses.

Edgar Filing: Avago Technologies LTD - Form 10-Q

During the quarter ended February 1, 2009, we repurchased \$3 million in principal amount of senior subordinated notes from the open market, resulting in a gain on extinguishment of debt of \$1 million.

Senior Credit Facility

As of January 31, 2010, we had a revolving senior secured credit facility in the amount of \$350 million which includes borrowing capacity available for letters of credit and for borrowings and is available to us and certain of our subsidiaries in U.S. dollars and other currencies. As of January 31, 2010, we had no borrowing amounts outstanding under the revolving credit facility, although we had \$15 million of letters of credit outstanding under the facility, which reduces the amount available under the revolving credit facility on a dollar-for-dollar basis.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three level hierarchy is applied to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under the guidance for fair value measurements are described below:

Level 1 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Our Level 1 assets include money market funds which are classified as cash and cash equivalents and investment funds deferred compensation plan assets. We measure money market funds and investment funds at quoted market price as they are traded in an active market with sufficient volume and frequency of transactions.

Level 2 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Our Level 2 assets include time deposits. We measure time deposits at fair value quoted by the banks which do not materially differ from the carrying values of these instruments in the financial statements.

Level 3 Level 3 inputs are unobservable inputs for the asset or liability in which there is little, if any market activity for the asset or liability at the measurement date. Level 3 assets and liabilities include cost method investment, goodwill, amortizable intangible assets, and property, plant and equipment, which are measured at fair value using a discounted cash flow approach when they are determined to be impaired. We did not have any Level 3 asset or liability activities during the quarter ended January 31, 2010.

Assets Measured at Fair Value on a Recurring Basis

The table below sets forth by level our financial assets that were accounted for at fair value as of January 31, 2010. The table does not include cash on hand and also does not include assets that are measured at historical cost or any basis other than fair value (in millions).

	Portion of Carrying Value Measured at Fair Value as of January 31, 2010	Fair Value Measurement as of January 31, 2010 Using Quoted Prices In Active Market For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Time deposits (1)	\$ 32	\$	\$ 32
Investment Funds - Deferred Compensation Plan Assets (2)	3	3	
Total assets measured at fair value	\$ 35	\$ 3	\$ 32

(1) Included in cash and cash equivalents in our unaudited condensed consolidated balance sheet

(2) Included in other current assets in our unaudited condensed consolidated balance sheet

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Assets Measured at Fair Value on a Nonrecurring Basis***

There was no nonfinancial asset or liability measured at fair value as of January 31, 2010.

Fair Value of Other Financial Instruments

The following table presents the carrying amounts and fair values of financial instruments as of November 1, 2009 and January 31, 2010 (in millions):

	November 1, 2009		January 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Variable rate debt	\$ 46	\$ 45	\$	\$
Fixed rate debt	548	586	230	257

The fair values of cash and cash equivalents, trade accounts receivable, accounts payable and accrued liabilities, to the extent the underlying liability will be settled in cash, approximate carrying values because of the short-term nature of these instruments. The fair value of our long-term debt is based on quoted market rates.

6. Shareholders' Equity***Share-Based Compensation***

We follow the accounting provisions of ASC 718 Compensation Stock Compensation, or ASC 718, for share-based awards granted to employees, directors, and non-employees.

The following table summarizes share-based compensation expense for the quarters ended February 1, 2009 and January 31, 2010 (in millions):

	Quarter Ended	
	February 1, 2009	January 31, 2010
Research and development	\$ 1	\$ 1
Selling, general and administrative	(1)	4
Total share-based compensation expense	\$	\$ 5

The weighted-average assumptions utilized for our Black-Scholes valuation model for options granted during the quarters ended February 1, 2009 and January 31, 2010 are as follows:

	Quarter Ended	
	February 1, 2009	January 31, 2010
Risk-free interest rate	1.8%	2.6%

Edgar Filing: Avago Technologies LTD - Form 10-Q

Dividend yield	0%	0%
Volatility	57.0%	47.0%
Expected term (in years)	6.5	5.0

The dividend yield of zero is based on the fact that we have no present intention to pay cash dividends. Expected volatility is based on the combination of historical volatility of guideline publicly traded companies over the period commensurate with the expected life of the options and the implied volatility of guideline publicly traded companies from traded options with a term of 180 days or greater measured over the last three months. The risk-free interest rate is derived from the average U.S. Treasury Strips rate during the period, which approximates the rate in effect at the time of grant. For the options granted during the quarter ended February 1, 2009, we used the simplified method specified by the SEC's Staff Accounting Bulletin No. 107 to determine the expected term of stock options. For options granted during the quarter ended January 31, 2010, our computation of expected term was based on other data, such as the data of peer companies and company-specific attributes that we believe could affect employees' exercise behavior.

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Based on the above assumptions, the weighted-average fair values of the options granted under the share option plans for the quarters ended February 1, 2009 and January 31, 2010 was \$4.65 and \$7.00, respectively.

Based on our historical experience of pre-vesting option cancellations, for the quarters ended February 1, 2009 and January 31, 2010 we have assumed an annualized forfeiture rate of 15% and 11%, respectively, for our options. We will record additional expense if actual forfeitures are lower than we estimated, and will record a recovery of prior expense if actual forfeitures are higher than we estimated.

Total compensation cost of options granted but not yet vested as of January 31, 2010 was \$57 million, which is expected to be recognized over the remaining weighted-average service period of 3 years.

A summary of award activity follows (in millions, except years and per share amounts).

	Awards Outstanding			Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
	Awards Available for Grant	Number Outstanding	Weighted-Average Exercise Price Per Share		
Balance as of November 1, 2009	20	24	\$ 8.69		
Granted	(1)	1	\$ 15.95		
Exercised		(1)	\$ 5.88		
Cancelled	1	(1)	\$ 10.19		
Balance as of January 31, 2010	20	23	\$ 8.92	7.22	\$ 196
Vested as of January 31, 2010		9	\$ 6.20	5.79	\$ 102
Vested and expected to vest as of January 31, 2010		20	\$ 8.61	7.06	\$ 180

The following table summarizes significant ranges of outstanding and exercisable awards as of January 31, 2010 (in millions, except years and per share amounts):

Exercise Prices	Awards Outstanding			Awards Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price Per Share	Number Exercisable	Weighted-Average Exercise Price Per Share
\$0.00-4.00	1	2.98	\$ 1.25	1	\$ 1.25
4.01-8.00	9	5.62	\$ 5.16	6	\$ 5.08
8.01-12.00	9	7.99	\$ 10.16	2	\$ 10.22
12.01-16.00	3	9.55	\$ 15.14		\$
16.01-20.00	1	9.62	\$ 17.13		\$
Total	23	7.22	\$ 8.92	9	\$ 6.20

Table of Contents**AVAGO TECHNOLOGIES LIMITED****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Restructuring Charges**

The significant activities within and components of restructuring charges during the quarter ended January 31, 2010 are as follows (in millions):

	Employee Termination Costs	Excess Lease	Total
Accrued restructuring as of November 1, 2009 - included in other current liabilities	\$ 2	\$ 1	\$ 3
Charges to operating expenses	1		1
Cash payments	(3)		(3)
Accrued restructuring as of January 31, 2010 - included in other current liabilities	\$	\$ 1	\$ 1

8. Income Taxes

For the quarter ended January 31, 2010, we recorded an income tax provision of \$4 million compared to a \$5 million income tax provision for the quarter ended February 1, 2009. The decrease of tax expense in the quarter ended January 31, 2010 is primarily attributable to change in distribution of jurisdictional income.

In February, 2010, the Malaysian government granted us a tax holiday on our qualifying Malaysian income, which is effective for ten years beginning with our fiscal year 2009. However, as a result of receiving this tax incentive, we will write down deferred tax assets of \$6 million that we previously recorded in this jurisdiction. As a result, we expect our income tax expense to be higher in the second quarter of fiscal year 2010.

9. Segment Information

ASC 280 Segment Reporting, or ASC 280, establishes standards for the way public business enterprises report information about operating segments in annual consolidated financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. ASC 280 also establishes standards for related disclosures about products and services, geographic areas and major customers. We have concluded that we have one reportable segment based on the following factors: sales of semiconductors represents our only material source of revenue; substantially all products offered incorporate analog functionality and are manufactured under similar manufacturing processes; we use an integrated approach in developing our products in that discrete technologies developed are frequently integrated across many of our products; we use a common order fulfillment process and similar distribution approach for our products; and broad distributor networks are typically utilized while large accounts are serviced by a direct sales force. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by ASC 280.

10. Related Party Transactions

We recorded \$1 million of expenses for the quarter ended February 1, 2009, for consulting and management advisory services provided by Kohlberg Kravis Roberts & Co., or KKR, and Silver Lake Partners, or Silver Lake. Pursuant to the advisory agreement, we also recorded less than \$1 million of advisory fees payable to each of KKR and Silver Lake during the quarter ended February 1, 2009 in connection with a qualifying acquisition. The advisory agreement was terminated in the fourth quarter of fiscal year 2009, in connection with our Initial Public Offering, or IPO, as such there were no advisory fees payable to KKR or Silver Lake during the quarter ended January 31, 2010.

Edgar Filing: Avago Technologies LTD - Form 10-Q

We recorded a credit to the unaudited condensed consolidated statement of operations of less than \$1 million and recorded less than \$1 million of charges for the quarters ended February 1, 2009 and January 31, 2010, respectively, in connection with variable accounting related to the options to purchase 800,000 ordinary shares granted to Capstone Consulting, a company affiliated with KKR. These options are no longer subject to variable accounting as 700,000 of the options vested by the end of the first quarter of fiscal year 2010 and 100,000 of the options expired as the performance targets related to these options were not met.

Until July 31, 2009, funds affiliated with Silver Lake were investors in Flextronics International Ltd. Mr. James A. Davidson, a director, also serves as a director of Flextronics. In the ordinary course of business, we continue to sell to Flextronics, which in the quarters ended February 1, 2009 and January 31, 2010 accounted for \$24 million and \$35 million of net revenue, respectively. Trade accounts receivable due from Flextronics as of November 1, 2009 and January 31, 2010 were \$16 million and \$15 million, respectively.

Table of Contents

AVAGO TECHNOLOGIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Mr. John R. Joyce, a director, also serves as a director of Hewlett-Packard Company. In the ordinary course of business, we continue to sell to Hewlett-Packard Company, which in the quarters ended February 1, 2009 and January 31, 2010 accounted for \$10 million and \$6 million of net revenue, respectively, and trade accounts receivable due from Hewlett-Packard Company as of November 1, 2009 and January 31, 2010 was \$4 million each, respectively. We also use Hewlett-Packard Company as a service provider for information technology services. For the quarters ended February 1, 2009 and January 31, 2010, operating expenses include \$9 million and \$2 million, respectively, for services provided by Hewlett-Packard Company.

Mr. James Diller, a director and the chairman of our board of directors, also serves on the board of directors of PMC Sierra, Inc., or PMC Sierra, as vice-chairman. In the ordinary course of business, we continue to sell to PMC Sierra, which in the quarters ended February 1, 2009 and January 31, 2010 accounted for \$1 million and zero, respectively, of net revenue. In addition, there were no trade accounts receivable due from PMC Sierra as of November 1, 2009 and January 31, 2010, respectively.

11. Commitments and Contingencies

Commitments

Purchase Commitments. At January 31, 2010, we had unconditional purchase obligations of \$37 million for fiscal year 2010 and none thereafter. These unconditional purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including fixed or minimum quantities to be purchased, fixed, minimum or variable price provisions and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

Debt. At January 31, 2010, we had debt obligations of \$230 million. Estimated future interest expense payments related to debt obligations at January 31, 2010 were \$22 million for the remainder of 2010, \$29 million for 2011, \$28 million for 2012, and \$27 million each for 2013, 2014, and 2015, respectively and \$3 million thereafter. Estimated future interest expense payments include interest payments on our outstanding notes, commitment fees, and letter of credit fees. See Note 4. Borrowings.

There were no other substantial changes to our contractual commitments during the first quarter of fiscal year 2010 from those disclosed in our Annual Report on Form 10-K for fiscal year 2009.

Contingencies

We are subject to certain routine legal proceedings, as well as demands, claims and threatened litigation, that arise in the normal course of our business, including assertions that we may be infringing patents or other intellectual property rights of others. We currently believe the ultimate amount of liability, if any, for any pending claims of any type (either alone or combined) will not materially affect our financial position, results of operations or cash flows. We also believe we would be able to obtain any necessary licenses or other rights to disputed intellectual property rights on commercially reasonable terms. However, the ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on us because of defense costs, negative publicity, timing of adverse resolutions, diversion of management resources and other factors. Our failure to obtain necessary license or other rights, or litigation arising out of intellectual property claims, could adversely affect our business.

On July 23, 2009, TriQuint Semiconductor, Inc. filed a complaint against us and certain of our subsidiaries in the U.S. District Court, District of Arizona seeking declaratory judgment that four of our patents relating to radio frequency, or RF, filter technology used in our wireless products are invalid and, if valid, that TriQuint's products do not infringe any of those patents. In addition, TriQuint claims that certain of our wireless products infringe three of its patents. TriQuint is seeking damages in an unspecified amount, treble damages for alleged willful infringement, attorneys fees and injunctive relief. On September 17, 2009, we filed our answer and counterclaim, denying infringement, asserting the invalidity of TriQuint's patents and asserting infringement by TriQuint of ten Avago patents. On October 16, 2009, TriQuint filed its answer to our counterclaim, denying infringement and filed an antitrust counterclaim and counterclaims for declaratory judgment of non infringement and invalidity. On November 24, 2009, we filed a motion to dismiss TriQuint's antitrust counterclaims, which motion has not yet been ruled on by the court. We intend to defend this lawsuit vigorously, which actions may include the assertion by us of counterclaims or additional claims against TriQuint related to our intellectual property portfolio.

Table of Contents

AVAGO TECHNOLOGIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Warranty

Commencing in the second quarter of fiscal year 2008, we notified certain customers of a product quality issue and began taking additional steps to correct the quality issue and work with affected customers to determine potential costs covered by our warranty obligations. We maintain insurance coverage for product liability and have been working with our insurance carriers to determine the extent of covered losses in this situation. Based on settlements with customers to date, the status of discussions with other affected customers and discussions with our insurance carriers, we recorded a charge of \$2 million during the fourth quarter of fiscal year 2009 to cover costs relating to this quality issue in excess of expected insurance coverage. We presently believe that amounts we have recorded in our financial statements along with expected insurance coverage proceeds will be adequate to resolve these claims, although this assessment is subject to change based on the ultimate resolution of this matter with customers and the insurance carriers. In addition, if the timing of settlement of claims with customers and the timing of determination of insurance recoveries do not occur in the same reporting periods, there could be material increases in charges to statement of operations in a future period and decreases in a subsequent period once insurance recoveries are deemed probable of realization.

During the second quarter of fiscal year 2009 we identified another product quality issue with a particular component, took steps to correct the quality issue and notified our customers. Though the expected failure rate of the product was not 100%, based on our quality tests, we have offered to replace all such components used or still held by our customers. We recorded charges of \$6 million during fiscal year 2009 related to this product quality issue, based on the progress of discussions with our customers and our evaluation of the best estimate of our exposure related to this matter, which covered costs to scrap inventory of such components held by us and costs associated with providing replacement parts to customers. During the first quarter of fiscal year 2010, we recorded additional charges of \$5 million to cover customer claims related to this product quality issue. We presently believe that amounts we have recorded in our financial statements will be adequate to resolve any warranty obligations related to this issue, although this assessment is subject to change based on the ultimate resolution of this matter with customers. We have made our best estimate of our expected warranty obligation, but we could record further charges in future periods based on the ultimate resolution of this matter.

Indemnifications to Hewlett-Packard and Agilent

Agilent Technologies, Inc. has given multiple indemnities to Hewlett-Packard Company in connection with its activities prior to its spin-off from Hewlett-Packard Company in June 1999 for the businesses that constituted Agilent prior to the spin-off. As the successor to the Semiconductor Products Group, or SPG, business of Agilent, we may acquire responsibility for indemnifications related to assigned intellectual property agreements. Additionally, when we completed the acquisition of SPG from Agilent in December 2005, we provided indemnities to Agilent with regard to Agilent's conduct of the SPG business prior to the SPG acquisition. In our opinion, the fair value of these indemnifications is not material.

Other Indemnifications

As is customary in our industry and as provided for in local law in the United States and other jurisdictions, many of our standard contracts provide remedies to our customers and others with whom we enter into contracts, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of our products. From time to time, we indemnify customers, as well as our suppliers, contractors, lessors, lessees, companies that purchase our businesses or assets and others with whom we enter into contracts, against combinations of loss, expense, or liability arising from various triggering events related to the sale and the use of our products, the use of their goods and services, the use of facilities and state of our owned facilities, the state of the assets and businesses that we sell and other matters covered by such contracts, usually up to a specified maximum amount. In addition, from time to time we also provide protection to these parties against claims related to undiscovered liabilities, additional product liability or environmental obligations. In our experience, claims made under such indemnifications are rare and the associated estimated fair value of the liability is not material.

12. Subsequent Event

On January 27, 2010, our registration statement filed with the Securities and Exchange Commission in connection with the public offering and sale by certain shareholders of the Company of an aggregate of 25,000,000 shares of the Company's ordinary shares, or the Offering, was declared effective. The Offering closed on February 2, 2010, and 25,000,000 shares were sold to the public at a price per share of \$17.41

Edgar Filing: Avago Technologies LTD - Form 10-Q

including a \$0.41 per share discount to the underwriters. We did not receive any proceeds from the sale of shares sold in the Offering other than proceeds from options exercised by certain shareholders in connection with the Offering. The underwriters exercised their option to purchase from certain selling shareholders up to an additional 3,750,000 ordinary shares to cover over-allotments on February 23, 2010, which transaction closed on February 26, 2010. In connection with the Offering, selling shareholders Bali Investments S.ar.l, Geysler Investments Pte. Ltd. and Seletar Investment Pte. Ltd. agreed to reimburse the Company for two-thirds of the expenses of the offering.

Table of Contents

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the fiscal year ended November 1, 2009, or fiscal year 2009, included in our Annual Report on Form 10-K for fiscal year 2009, or 2009 Annual Report on Form 10-K. This Quarterly Report on Form 10-Q may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, which are made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact could be deemed forward-looking, including, but not limited to, any projections of financial information; any statements about historical results that may suggest trends for our business; any statements of the plans, strategies, and objectives of management for future operations; any statements of expectation or belief regarding future events, technology developments, or enforceability of our intellectual property rights; and any statements of assumptions underlying any of the foregoing. These forward-looking statements are based on current expectations, estimates, forecasts and projections of future Avago or industry performance based on management's judgment, beliefs, current trends and market conditions and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. Accordingly, we caution you not to place undue reliance on these statements. These statements include those related to our products, product sales, expenses, liquidity, cash flow, growth rates and restructuring efforts. For example, there can be no assurance that our product sales efforts, revenues or expenses will meet any expectations or follow any trend(s), or that our ability to compete effectively will be successful or yield anticipated results. Important factors that could cause actual results to differ materially from our expectations are disclosed under "Risk Factors" in our 2009 Annual Report on Form 10-K, in Part II, Item 1A of this Quarterly Report on Form 10-Q, and in other documents we file from time to time with the SEC. We undertake no intent or obligation to publicly update or revise any of these forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are a leading designer, developer and global supplier of a broad range of analog semiconductor devices with a focus on III-V based products. III-V semiconductor materials have higher electrical conductivity and thus tend to have better performance characteristics in radio frequency, or RF, and optoelectronic applications than silicon. We differentiate ourselves through our high performance design and integration capabilities. We serve four primary target markets: wireless communications, wired infrastructure, industrial and automotive electronics, and consumer and computing peripherals. Applications for our products in these target markets include cellular phones, consumer appliances, data networking and telecommunications equipment, enterprise storage and servers, factory automation, displays, optical mice and printers.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. Our critical accounting policies are those that affect our historical financial statements materially and involve difficult, subjective or complex judgments by management. Those policies include revenue recognition, valuation of long-lived assets, intangible assets and goodwill, inventory valuation and warranty reserves, accounting for income taxes and share-based compensation.

There have been no significant changes in our critical accounting policies during the quarter ended January 31, 2010 compared to what was previously disclosed in "Critical Accounting Policies and Estimates" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our 2009 Annual Report on Form 10-K.

Table of Contents**Results from Operations**

Quarter Ended January 31, 2010 Compared to Quarter Ended February 1, 2009

The following tables set forth our results of operations for the quarters ended January 31, 2010 and February 1, 2009.

	February 1, 2009	January 31, 2010	Quarter Ended	
	(In millions)		February 1, 2009	January 31, 2010
			(As a percentage of net revenue)	
Statement of Operations Data:				
Net revenue	\$ 368	\$ 456	100 %	100 %
Costs and expenses:				
Cost of products sold:				
Cost of products sold	204	247	55	54
Amortization of intangible assets	15	15	4	3
Restructuring charges	6		2	
Total cost of products sold	225	262	61	57
Research and development	62	64	17	14
Selling, general and administrative	40	46	11	10
Amortization of intangible assets	6	5	2	2
Restructuring charges	5	1	1	
Total costs and expenses	338	378	92	83
Income from operations	30	78	8	17
Interest expense	(18)	(11)	(5)	(2)
Gain (loss) on extinguishment of debt	1	(24)		(6)
Other expense, net	(2)	(1)		
Income before income taxes	11	42	3	9
Provision for income taxes	5	4	1	1
Net income	\$ 6	\$ 38	2%	8%

Net revenue. Substantially all of our net revenue is derived from sales of semiconductor devices which our customers incorporate into electronic products. We sell our products primarily through our direct sales force. We also use distributors for a portion of our business and recognize revenue upon delivery of product to the distributors. Such revenue is reduced for estimated returns and distributor allowances.

Net revenue was \$456 million for the quarter ended January 31, 2010, compared to \$368 million for the quarter ended February 1, 2009, an increase of \$88 million or 24%. Net revenue increased primarily due to strength in the wireless communications target market.

Table of Contents

Net revenue by target market data is derived from our understanding of our end customers' primary markets, and was as follows:

	Quarter Ended		Change
	February 1, 2009	January 31, 2010	
% of net revenue			
Wireless communications	34%	38%	4%
Wired infrastructure	28	26	(2)
Industrial and automotive electronics	28	26	(2)
Consumer and computing peripherals	10	10	
Total net revenue	100%	100%	

	Quarter Ended		Change
	February 1, 2009	January 31, 2010	
Net revenue (in millions)			
Wireless communications	\$ 124	\$ 173	\$ 49
Wired infrastructure	103	120	17
Industrial and automotive electronics	104	117	13
Consumer and computing peripherals	37	46	9
Total net revenue	\$ 368	\$ 456	\$ 88

Net revenue from wireless communications products, both in absolute dollars and as a percentage of net revenue, increased in the first quarter of the fiscal year ending October 31, 2010, or fiscal year 2010, compared with the corresponding prior year period. The growth of key platforms in next-generation smart phones at leading OEM customers, which incorporate many of our proprietary products such as 3G front-end modules and data cards, as well as increased demand for our proprietary optical finger navigation devices, drove this revenue growth.

Net revenue from wired infrastructure products, in absolute dollars, increased in the first quarter of fiscal year 2010 compared with the corresponding prior year period, primarily due to an increase in spending in the enterprise networking and data center areas in the first fiscal quarter.

Net revenue from industrial and automotive electronics products, in absolute dollars, increased in the first quarter of fiscal year 2010 compared with the corresponding prior year period, as the overall end market continued to improve, with strong demand from major OEMs in the Asia Pacific region.

Net revenue from consumer and computer peripheral products, in absolute dollars, increased in the first quarter of fiscal year 2010 compared with the corresponding prior year period, reflecting improved sales of optical mouse sensors and motion control encoders for optical disc drives in the first quarter of fiscal year 2010.

The categorization of revenue by target market is determined using a variety of data points, including the technical characteristics of the product, the sold to customer information, the ship to customer information and the end customer product or application into which our product will be incorporated. As data systems for capturing and tracking this data evolve and improve, the categorization of products by target market can vary over time. When this occurs, we reclassify revenue by target market for prior periods. Such reclassifications typically do not materially change the sizing of, or the underlying trends of results within, each target market.

Cost of products sold. Cost of products sold consists primarily of the cost of semiconductor wafers and other materials, and the cost of assembly and test. Cost of products sold also includes personnel costs and overhead related to our manufacturing operations, including share-based compensation, and related occupancy, computer services and equipment costs, manufacturing quality, order fulfillment, warranty and inventory adjustments, including write-downs for inventory obsolescence, energy costs and other manufacturing expenses. Total cost of products sold also includes amortization of intangible assets and restructuring charges.

Edgar Filing: Avago Technologies LTD - Form 10-Q

Total cost of products sold (which includes amortization of manufacturing-related intangible assets and restructuring charges) was \$262 million for the quarter ended January 31, 2010, compared to \$225 million for the quarter ended February 1, 2009, an increase of \$37 million or 16%. As a percentage of net revenue, total cost of products sold decreased to 57% for the quarter ended January 31, 2010 from 61% for the quarter ended February 1, 2009. The increase in absolute dollars was primarily attributable to increase in revenue of 24% during the quarter ended January 31, 2010 compared to the prior year period ended February 1, 2009. The decrease as a percentage of net revenue is primarily due to favorable product mix. During the quarter ended January 31, 2010, we also recorded a charge of \$5 million to cover potential costs for warranty obligations arising out of a certain product quality issue identified in the second quarter of fiscal year 2009, as more fully discussed in Note 11 to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Table of Contents

Cost of products sold (which excludes amortization of manufacturing-related intangible assets and restructuring) was \$247 million for the quarter ended January 31, 2010, compared to \$204 million for the quarter ended February 1, 2009, an increase of \$43 million or 21%. As a percentage of net revenue, cost of products sold decreased slightly to 54% for the quarter ended January 31, 2010 compared from 55% for the quarter ended February 1, 2009. The increase in absolute dollars was primarily attributable to an increase in net revenue during the quarter ended January 31, 2010, as discussed above.

Research and development. Research and development expense consists primarily of personnel costs for our engineers engaged in the design and development of our products and technologies, including share-based compensation. These expenses also include project material costs, third-party fees paid to consultants, prototype development expenses, allocated facilities costs and other corporate expenses and computer services costs related to supporting computer tools used in the engineering and design process.

Research and development expense was \$64 million for the quarter ended January 31, 2010, compared to \$62 million for the quarter ended February 1, 2009, an increase of \$2 million or 3%. As a percentage of net revenue, research and development expenses decreased to 14% for the quarter ended January 31, 2010 from 17% for the quarter ended February 1, 2009. The decrease as a percentage of net revenue is primarily attributable to an increase in net revenue during the quarter ended January 31, 2010.

Selling, general and administrative. Selling expense consists primarily of compensation and associated costs for sales and marketing personnel, including share-based compensation, sales commissions paid to our independent sales representatives, costs of advertising, trade shows, corporate marketing, promotion, travel related to our sales and marketing operations, related occupancy and equipment costs and other marketing costs. General and administrative expense consists primarily of compensation and associated costs, including share-based compensation, for executive management, finance, human resources and other administrative personnel, outside professional fees, allocated facilities costs and other corporate expenses.

Selling, general and administrative expense was \$46 million for the quarter ended January 31, 2010 compared to \$40 million for the quarter ended February 1, 2009, an increase of \$6 million or 15%. As a percentage of net revenue, selling, general and administrative decreased slightly to 10% for the quarter ended January 31, 2010 compared to 11% for the quarter ended February 1, 2009. The increase in absolute dollars was attributable to higher litigation expense and share based compensation expense, partially offset by lower incentive compensation expense due to the impact of our headcount reductions throughout fiscal year 2009.

Amortization of intangible assets. Total amortization of intangible assets charged incurred was \$20 million and \$21 million, respectively, for the quarters ended January 31, 2010 and February 1, 2009. The decrease is attributable to certain intangible assets becoming fully amortized during the year ended November 1, 2009, partially offset by additions to intangible assets during the year ended November 1, 2009.

Restructuring charges. During the quarter ended January 31, 2010, we incurred total restructuring charges of \$1 million, compared to \$11 million for the quarter ended February 1, 2009. During the first quarter of fiscal year 2009, we initiated several restructuring plans in response to the economic downturn that were substantially completed by the end of fiscal year 2009. See Note 7 to the Unaudited Condensed Consolidated Financial Statements.

Interest expense. Interest expense was \$11 million for the quarter ended January 31, 2010, compared to \$18 million for the quarter ended February 1, 2009, which represents a decrease of \$7 million or 39%. The decrease is primarily due to the redemption and repurchases of \$470 million in aggregate principal amount of our outstanding notes made subsequent to the first quarter of fiscal year 2009. We presently estimate that the cash portion of our interest expense for fiscal year 2010 will be \$32 million.

Gain (loss) on extinguishment of debt. During the quarter ended January 31, 2010, we redeemed \$318 million aggregate principal amount of our senior fixed rate notes and the remaining \$46 million aggregate principal amount of our senior floating rate notes. The redemption of the senior fixed rate notes and senior floating rate notes resulted in a loss on extinguishment of debt of \$24 million. During the quarter ended February 1, 2009, we repurchased \$3 million in principal amount of senior subordinated notes in the open market, resulting in a gain on extinguishment of debt of \$1 million during the quarter ended February 1, 2009. See Note 4 to the Unaudited Condensed Consolidated Financial Statements.

Other income (expense), net. Other income (expense), net includes interest income, currency gains (losses) on balance sheet remeasurement and other miscellaneous items. Other expense, net was \$1 million for the quarter ended January 31, 2010 compared to other expense, net of \$2 million for the quarter ended February 1, 2009.

Provision for income taxes. We recorded income tax expense of \$4 million for the quarter ended January 31, 2010 compared to \$5 million for the quarter ended February 1, 2009. The decrease is primarily attributable to change in distribution of jurisdictional income.

Table of Contents

In February, 2010, the Malaysian government granted us a tax holiday on our qualifying Malaysian income, which is effective for ten years beginning with our fiscal year 2009. However, as a result of receiving this tax incentive, we will write down deferred tax assets of \$6 million that we previously recorded in this jurisdiction. As a result, we expect our income tax expense to be higher in the second quarter of fiscal year 2010.

Backlog

Our sales are generally made pursuant to short-term purchase orders. These purchase orders are made without deposits and may be rescheduled, canceled or modified on relatively short notice, and in most cases without substantial penalty. Therefore, we believe that purchase orders or backlog are not a reliable indicator of future sales.

Seasonality

Sales of consumer electronics are higher during the calendar year end period, and as a result, we typically experience higher revenues during our fourth fiscal quarter while sales typically decline in our first fiscal quarter.

Liquidity and Capital Resources

Our primary sources of liquidity as at January 31, 2010, consisted of: (1) approximately \$144 million in cash and cash equivalents, (2) cash we expect to generate from operations and (3) our \$350 million revolving credit facility, which is committed until 2011, of which \$335 million is available to be drawn (after taking into account \$15 million of letters of credit outstanding under the facility). Our short-term and long-term liquidity requirements primarily arise from: (i) interest and principal payments related to our debt obligations, (ii) working capital requirements and (iii) capital expenditures, including acquisitions from time to time.

We believe that our cash and cash equivalents on hand, and cash flows from operations, combined with availability under our revolving credit facility, will provide sufficient liquidity to fund our current obligations, projected working capital requirements and capital spending for at least the next 12 months.

On December 1, 2009, we used the remaining net proceeds from our IPO in August 2009 to fund a portion of the redemption of an aggregate of \$364 million principal amount of our outstanding notes, consisting of the remaining \$318 million principal amount of our senior fixed rate notes and the remaining \$46 million principal amount of our senior floating rate notes, pursuant to the terms of the indenture governing those notes. We paid an aggregate of \$351 million in respect of the redemption of senior fixed rate notes and approximately \$46 million in respect of the redemption of the senior floating rate notes, including accrued and unpaid interest to but not including the redemption date.

Our ability to service our senior subordinated notes and any indebtedness we incur under our revolving credit facility will depend on our ability to generate cash in the future. We may not have significant cash available to meet any large unanticipated liquidity requirements, other than from available borrowings, if any, under our revolving credit facility. As a result, we may not retain a sufficient amount of cash to finance growth opportunities, including acquisitions, or unanticipated capital expenditures or to fund our operations. If we do not have sufficient cash for these purposes, our financial condition and our business could suffer.

In summary, our cash flows were as follows (in millions):

	Quarter Ended	
	February 1, 2009	January 31, 2010
Net cash (used in) provided by operating activities	\$ (4)	\$ 41
Net cash used in investing activities	(12)	(9)
Net cash used in financing activities	(2)	(360)
Net decrease in cash and cash equivalents	\$ (18)	\$ (328)

Cash Flows for the Quarters Ended January 31, 2010 and February 1, 2009

Operating Activities

Net cash provided by operating activities during the quarter ended January 31, 2010 was \$41 million. The net cash provided by operating activities was principally due to net income of \$38 million and non-cash charges of \$54 million, offset by changes in operating assets and liabilities of \$51 million. The non-cash charges of \$54 million included \$39 million for depreciation and amortization, \$8 million of debt issuance costs written off in connection with our debt redemption and \$5 million of share-based compensation. Net income was also reduced by \$16 million for the premium paid on our debt redemption which is included in the \$24 million loss on extinguishment of debt in the unaudited condensed consolidated statement of operations.

Table of Contents

Accounts receivable at the end of the first quarter of fiscal year 2010 increased by \$17 million, or 9%, from the amount at the end of fiscal year 2009. The number of days sales outstanding increased slightly to 41 days at January 31, 2010 from 40 days at November 1, 2009. We use the current quarter revenue in our calculation of number of days sales outstanding.

Inventory increased to \$166 million at January 31, 2010 from \$162 million at the end of fiscal year 2009. Inventory days on hand slightly decreased from 62 days at November 1, 2009 to 61 days at January 31, 2010. We use the current quarter cost of products sold in our calculation of days of hands of inventory.

Current liabilities decreased from \$633 million at the end of fiscal year 2009 to \$248 million at the end of the first quarter of fiscal year 2010 mainly due to the redemption of \$364 million of long-term debt that was classified as current at November 1, 2009 (as it had been irrevocably called for redemption before the fiscal year end) and decreases in employee compensation and benefit accruals and accrued interest. Accounts payable increased by \$6 million or 4% from fiscal year 2009 mainly due to timing of disbursements. The decrease in employee compensation and benefit accruals from November 1, 2009 is attributable to our payments under employee bonus plans. Accrued interest decreased \$20 million or 80% from fiscal year 2009 mainly due to the debt redemption and semi-annual interest payments made during the first quarter of fiscal year 2010.

Net cash used in operating activities during the quarter ended February 1, 2009 was \$4 million. The net cash used in operating activities was primarily due to decreases in operating assets and liabilities of \$51 million, offset by net income of \$6 million and non-cash charges of \$41 million for depreciation and amortization.

Inventory decreased to \$178 million at February 1, 2009 from \$188 million at the end of fiscal year 2008. Inventory days on hand increased from 65 days at November 2, 2008 to 79 days at February 1, 2009. The inventory balance at the end of fiscal year 2008 was higher mainly due to seasonality.

Current liabilities decreased from \$328 million at the end of fiscal year 2008 to \$278 million at the end of the first quarter of fiscal year 2009 mainly due to the decreases in accounts payable, employee compensation and benefit accruals and other current liabilities. Accounts payable decreased by \$5 million or 3% from fiscal year 2008, mainly due to timing of disbursements. The decrease in employee compensation and benefit accruals from November 2, 2008 is attributable to our payments under employee bonus plans and usage of accrued vacation. The decrease in other current liabilities resulted from semi-annual interest payments on our long-term debt.

Investing Activities

Net cash used in investing activities for the quarter ended January 31, 2010 was \$9 million, due to purchases of property, plant and equipment of \$9 million.

Net cash used in investing activities for the quarter ended February 1, 2009 was \$12 million, related to purchases of property, plant and equipment of \$12 million.

Financing Activities

Net cash used in financing activities for the quarter ended January 31, 2010 was \$360 million. The net cash used in financing activities was principally from the redemption of \$318 million in principal amount of senior fixed rate notes and \$46 million principal amount of senior floating rate notes, offset by \$4 million provided by the issuance of ordinary shares. Net cash used in financing activities for the quarter ended February 1, 2009 was not significant.

Indebtedness

As of January 31, 2010, we had \$230 million aggregate principal amount of our senior subordinated notes outstanding and \$5 million of capital lease obligations. As at such date, we had an additional \$335 million of borrowing capacity available under our revolving credit facility (after taking into account \$15 million of outstanding letters of credit, which reduce the amount available under our revolving credit facility on a dollar for dollar basis).

Contractual Commitments

Edgar Filing: Avago Technologies LTD - Form 10-Q

Purchase Commitments. At January 31, 2010, we had unconditional purchase obligations of \$37 million for fiscal year 2010 and none thereafter. These unconditional purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including fixed or minimum quantities to be purchased, fixed, minimum or variable price provisions and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

Table of Contents

Debt. At January 31, 2010, we had debt obligations of \$230 million. Estimated future interest expense payments related to debt obligations at January 31, 2010 were \$22 million for the remainder of 2010, \$29 million for 2011, \$28 million for 2012, and \$27 million each for 2013, 2014, and 2015, respectively and \$3 million thereafter. Estimated future interest expense payments include interest payments on our outstanding notes, commitment fees, and letter of credit fees. See Note 4 Borrowings in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

There were no other substantial changes to our contractual commitments during the first quarter of fiscal year 2010 from those disclosed in our Annual Report on Form 10-K for the fiscal year ended November 1, 2009.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements at January 31, 2010 as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Accounting Changes and Recent Accounting Standards

For a description of accounting changes and recent accounting standards, including the expected dates of adoption and estimated effects, if any, on our unaudited consolidated condensed financial statements, see Note 1: Overview and Basis of Presentation in the Notes to Unaudited Condensed Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Refer to Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk, in our 2009 Annual Report on Form 10-K. There have been no material changes in market risk from the information reported in our 2009 Annual Report on Form 10-K.

Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures.* Our management, with the participation of our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, evaluated the effectiveness of our disclosure controls and procedures as of January 31, 2010. We maintain disclosure controls and procedures that are intended to ensure that the information required to be disclosed in our Exchange Act filings is properly and timely recorded, processed, summarized and reported. These disclosure controls and procedures are also intended to ensure that information is accumulated and communicated to management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, our CEO and CFO concluded that, as of January 31, 2010, our disclosure controls and procedures were effective.

In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

(b) *Changes in Internal Controls Over Financial Reporting.* There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in litigation that we believe is of the type common to companies engaged in our line of business, including commercial disputes and employment issues. As of the date of this filing, we are not involved in any pending legal proceedings that we believe would likely have a material adverse effect on our financial condition, results of operations or cash flows. However, certain pending disputes involve claims by third parties that our activities infringe their patent, copyright, trademark or other intellectual property rights. These claims generally involve the demand by a third-party that we cease the manufacture, use or sale of the allegedly infringing products, processes or technologies and/or pay substantial damages or royalties for past, present and future use of the allegedly infringing intellectual property. For example, on July 23, 2009, TriQuint Semiconductor, Inc. filed a complaint against us and certain of our subsidiaries in the U.S. District Court, District of Arizona seeking declaratory judgment that four of our patents relating to RF filter technology used in our wireless products are invalid and, if valid, that TriQuint's products do not infringe any of those patents. In addition, TriQuint claims that certain of our wireless products infringe three of its patents. TriQuint is seeking damages in an unspecified amount, treble damages for alleged willful infringement, attorneys fees and injunctive relief. On September 17, 2009, we filed our answer and counterclaim, denying infringement, asserting the invalidity of TriQuint's patents and asserting infringement by TriQuint of ten Avago patents. On October 16, 2009, TriQuint filed its answer to our counterclaim, denying infringement and filed an antitrust counterclaim and counterclaims for declaratory judgment of non infringement and invalidity. On November 24, 2009, we filed a motion to dismiss TriQuint's antitrust counterclaims. We intend to defend this lawsuit vigorously, which actions may include the assertion by us of counterclaims or additional claims against TriQuint related to our intellectual property portfolio.

In addition, on February 8, 2010, PixArt Imaging Inc. filed an action against us in the California Northern District Court seeking a determination of whether PixArt is licensed to use our portfolio of patents for optical finger navigation products pursuant to an existing cross-license agreement between us and PixArt which is limited to optical mouse and optical mouse trackball products. We did not license to PixArt our patents for optical finger navigation products. We intend to defend this action vigorously and to seek to have the scope of the cross-license agreement properly construed by the court as excluding such products.

Claims that our products or processes infringe or misappropriate any third-party intellectual property rights (including claims arising through our contractual indemnification of our customers) often involve highly complex, technical issues, the outcome of which is inherently uncertain. Moreover, from time to time we pursue litigation to assert our intellectual property rights. Regardless of the merit or resolution of any such litigation, complex intellectual property litigation is generally costly and diverts the efforts and attention of our management and technical personnel.

Item 1A. Risk Factors

A description of the risk factors associated with our business is set forth below. We review and, where applicable, update our risk factors each quarter. The description set forth below supersedes the description of the risk factors previously disclosed in Part I, Item 1A of our 2009 Annual Report on Form 10-K. These risk factors, which could materially affect our business, financial conditions or results of operations, are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also adversely affect our business, financial condition

Risks Related to Our Business

The recent economic downturn and financial crisis has negatively affected our business and continuing poor economic conditions may negatively affect our future business, results of operations, and financial condition.

The ongoing global recession and recent financial crisis has led to slower economic activity, unemployment, concerns about inflation and energy costs, decreased business and consumer confidence, reduced corporate profits and capital spending, adverse business conditions and lower levels of liquidity in many financial markets. Consumers and businesses have deferred purchases in response to tighter credit and negative financial news, which has in turn negatively affected product demand and other related matters. The global recession led to reduced customer spending in the semiconductor market and in our target markets during 2009, made it difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and caused U.S. and foreign businesses to slow spending on our products. While there seem to be signs of recovery in many areas of the global economy, continuing poor global economic conditions will likely cause additional reductions in customer spending and could lead to the insolvency of key suppliers resulting in product delays, lead to customer insolvencies, and also result in

Edgar Filing: Avago Technologies LTD - Form 10-Q

counterparty failures that may negatively impact our treasury operations. As a result, our business, financial condition and result of operations have been negatively affected in prior periods, and, if the downturn continues or worsens, could be materially adversely affected in future periods.

Table of Contents

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

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change and price erosion, evolving technical standards, short product life cycles (for semiconductors and for the end-user products in which they are used) and wide fluctuations in product supply and demand. From time to time, these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry in general and in our business in particular. For example, the global semiconductor market experienced a very substantial decline in 2001 and experienced a significant decline in 2009 due to the current economic downturn. Periods of industry downturns, including the current economic downturn, have been characterized by diminished demand for end-user products, high inventory levels, underutilization of manufacturing capacity, changes in revenue mix and accelerated erosion of average selling prices. In the current economic downturn, we have not been able to grow our revenues or reduce our costs quickly enough to maintain our operating profitability. The current economic downturn has had, and any future economic downturns could have, an adverse effect on our business, financial condition and results of operations.

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

Our revenues and operating results have fluctuated in the past and are likely to fluctuate in the future. These fluctuations may occur on a quarterly and annual basis and are due to a number of factors, many of which are beyond our control. These factors include, among others:

changes in end-user demand for the products manufactured and sold by our customers;

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

fluctuations in the levels of component inventories held by our customers;

the gain or loss of significant customers;

market acceptance of our products and our customers' products;

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

the timing and extent of product development costs;

new product announcements and introductions by us or our competitors;

incurrence of research and development and related new product expenditures;

seasonality or cyclical fluctuations in our markets;

currency fluctuations;

Edgar Filing: Avago Technologies LTD - Form 10-Q

utilization of our internal manufacturing facilities;

fluctuations in manufacturing yields;

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

availability and cost of raw materials from our suppliers;

changes in our product mix or customer mix;

intellectual property disputes;

loss of key personnel or the shortage of available skilled workers;

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

changes in our tax incentive arrangements or structure, which may adversely affect our net tax expense in any quarter in which such an event occurs.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly or annual operating results. In addition, a significant amount of our operating expenses are relatively fixed in nature due to our significant sales, research and development and internal manufacturing overhead costs. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations.

Table of Contents

If we do not adapt to technological changes in the semiconductor industry, we could lose customers or market share.

The semiconductor industry is subject to constant and rapid changes in technology, frequent new product introductions, short product life cycles, rapid product obsolescence and evolving technical standards. Technological developments may reduce the competitiveness of our products and require unbudgeted upgrades that could be expensive and time consuming to implement. Our products could become obsolete sooner than we expect because of faster than anticipated, or unanticipated, changes in one or more of the technologies related to our products. Furthermore, we continually evaluate expenditures for research and development and must choose among alternative technologies based on our expectations of future market growth and other factors. We may be unable to develop and introduce new or enhanced products that satisfy customer requirements and achieve market acceptance in a timely manner or at all, the technologies where we have focused our research and development expenditures may not become commercially successful, and we may be unable to anticipate new industry standards and technological changes. We also may not be able to respond successfully to new product announcements and introductions by competitors. If we fail to adapt successfully to technological changes or fail to obtain access to important new technologies, we may be unable to retain customers, attract new customers or sell new products to our existing customers.

Dependence on contract manufacturing and outsourcing other portions of our supply chain may adversely affect our ability to bring products to market and damage our reputation.

We operate a primarily outsourced manufacturing business model that principally utilizes third-party foundry and assembly and test capabilities. As a result, we are highly reliant on third-party foundry wafer fabrication and assembly and test capacity, including sole sourcing for many components or products. For certain of our product families, substantially all of our revenue from those products is derived from semiconductors fabricated by external foundries such as Taiwan Semiconductor Manufacturing Company Ltd., or TSMC and WIN Semiconductors Corp. We also use third-party contract manufacturers for a significant majority of our assembly and test operations, including Amertron Incorporated, Amkor Technology, and the Hana Microelectronics Public Company Ltd. group of companies. The ability and willingness of our contract manufacturers to perform is largely outside of our control. If one or more of our contract manufacturers or other outsourcers fails to perform its obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market and our reputation could suffer. If one of our suppliers ceases to, or is unable to, manufacture such a component or supply is otherwise constrained, we may be forced to re-engineer a product or may fail to meet customer demand. In addition to discontinuing parts, suppliers may also extend lead times, limit supplies or increase prices due to capacity constraints or other factors. For example, in the event that manufacturing capacity is reduced or eliminated at one or more facilities, including as a response by contract manufacturers to the recent worldwide decline in the semiconductor industry, manufacturing could be disrupted, we could have difficulties fulfilling our customer orders and our net revenue could decline. In addition, if these third parties on whom we are highly reliant fail to deliver quality products and components on time and at reasonable prices, we could have difficulties fulfilling our customer orders and our net revenue could decline. In such events, our business, financial condition and results of operations would be adversely affected.

To the extent we rely on third-party manufacturing relationships, we face the following risks:

inability of our manufacturers to develop manufacturing methods appropriate for our products and their unwillingness to devote adequate capacity to produce our products;

manufacturing costs that are higher than anticipated;

reduced control over product reliability;

more complicated supply chains;

inability to maintain continuing relationships with our suppliers;

Edgar Filing: Avago Technologies LTD - Form 10-Q

time, expense and uncertainty in identifying and qualifying additional suppliers; and

reduced control over delivery schedules and products costs.

Much of our outsourcing takes place in developing countries, and as a result may additionally be subject to geopolitical uncertainty. See Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business and other factors related to our international operations.

Table of Contents

A prolonged disruption of our manufacturing facilities could have a material adverse effect on our business, financial condition and results of operations.

Although we operate using a primarily outsourced manufacturing business model, we do rely on the manufacturing facilities we own, in particular our fabrication facilities in Fort Collins, Colorado and Singapore. We maintain our internal fabrication facilities for products utilizing our innovative materials and processes, to protect our intellectual property and to develop the technology for manufacturing. A prolonged disruption or material malfunction of, interruption in or the loss of operations at one or more of our production facilities, especially our Fort Collins and Singapore facilities, or the failure to maintain our labor force at one or more of these facilities, would limit our capacity to meet customer demands and delay new product development until a replacement facility and equipment, if necessary, were found. The replacement of the manufacturing facility could take an extended amount of time before manufacturing operations could restart. The potential delays and costs resulting from these steps could have a material adverse effect on our business, financial condition and results of operations.

Unless we and our suppliers continuously improve manufacturing efficiency and quality, our financial performance could be adversely affected.

Manufacturing semiconductors involves highly complex processes that require advanced equipment. We and our suppliers, as well as our competitors, continuously modify these processes in an effort to improve yields and product performance. Defects or other difficulties in the manufacturing process can reduce yields and increase costs. Our manufacturing efficiency will be an important factor in our future financial performance, and we may be unable to maintain or increase our manufacturing efficiency to the same extent as our competitors. For products that we outsource manufacturing, our product yields and performance will be subject to the manufacturing efficiencies of our third-party suppliers.

From time to time, we and our suppliers have experienced difficulty in beginning production at new facilities, transferring production to other facilities, achieving and maintaining a high level of process quality and effecting transitions to new manufacturing processes, all of which have caused us to suffer delays in product deliveries or reduced yields. We and our suppliers may experience manufacturing problems in achieving acceptable yields or experience product delivery delays in the future as a result of, among other things, capacity constraints, construction delays, transferring production to other facilities, upgrading or expanding existing facilities or changing our process technologies, any of which could result in a loss of future revenues. Our results of operations could be adversely affected by any increase in costs related to increases in production capacity if revenues do not increase proportionately.

Winning business is subject to lengthy, competitive selection processes that require us to incur significant expense. Even if we begin a product design, a customer may decide to cancel or change its product plans, which could cause us to generate no revenues from a product and adversely affect our results of operations.

We are focused on winning competitive bid selection processes, known as design wins, to develop semiconductors for use in our customers products. These selection processes are typically lengthy and can require us to incur significant design and development expenditures and dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not win the competitive selection process and may never generate any revenue despite incurring significant design and development expenditures. These risks are exacerbated by the fact that many of our products will likely have very short life cycles. Failure to obtain a design win sometimes prevents us from offering an entire generation of a product. This can result in lost revenues and could weaken our position in future competitive selection processes.

After winning a product design, we may experience delays in generating revenue from our products as a result of the lengthy development cycle typically required. In addition, a delay or cancellation of a customer's plans could materially and adversely affect our financial results, as we may have incurred significant expense in the design process and generated no revenue. Finally, our customers' failure to successfully market and sell their products could reduce demand for our products and materially adversely affect our business, financial condition and results of operations.

Table of Contents

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

The semiconductor industry is characterized by companies holding large numbers of patents, copyrights, trademarks and trade secrets and by the vigorous pursuit, protection and enforcement of intellectual property rights. From time to time, third parties assert against us and our customers and distributors their patent, copyright, trademark, trade secret and other intellectual property rights to technologies that are important to our business. For example, on July 23, 2009, TriQuint Semiconductor, Inc. filed a complaint against us and certain of our subsidiaries in the U.S. District Court, District of Arizona seeking declaratory judgment that four of our patents relating to RF filter technology used in our wireless products are invalid and, if valid, that TriQuint's products do not infringe any of those patents. In addition, TriQuint claims that certain of our wireless products infringe three of its patents. TriQuint is seeking damages in an unspecified amount, treble damages for alleged willful infringement, attorneys fees and injunctive relief. On September 17, 2009, we filed our answer and counterclaim, denying infringement, asserting the invalidity of TriQuint's patents and asserting infringement by TriQuint of ten Avago patents. On October 16, 2009, TriQuint filed its answer to our counterclaim, denying infringement and filed an antitrust counterclaim and counterclaims for declaratory judgment of non infringement and invalidity. On November 24, 2009, we filed a motion to dismiss TriQuint's antitrust counterclaims, which motion has not yet been ruled on by the court. We intend to defend this lawsuit vigorously, which actions may include the assertion by us of counterclaims or additional claims against TriQuint related to our intellectual property portfolio.

Claims that our products or processes infringe or misappropriate these rights, regardless of their merit or resolution, are frequently costly and divert the efforts and attention of our management and technical personnel. In addition, many of our customer agreements and in some cases our asset sale agreements require us to indemnify our customers or purchasers for third-party intellectual property infringement claims, which have in the past and may in the future require that we defend those claims and might require that we pay damages in the case of adverse rulings. Claims of this sort could also harm our relationships with our customers and might deter future customers from doing business with us. We do not know whether we will prevail in such proceedings given the complex technical issues and inherent uncertainties in intellectual property litigation. If any pending or future proceedings result in an adverse outcome, we could be required to:

cease the manufacture, use or sale of the infringing products, processes or technology;

pay substantial damages for past, present and future use of the infringing technology;

expend significant resources to develop non-infringing technology;

license technology from the third-party claiming infringement, which license may not be available on commercially reasonable terms, or at all;

enter into cross-licenses with our competitors, which could weaken our overall intellectual property portfolio;

lose the opportunity to license our technology to others or to collect royalty payments based upon successful protection and assertion of our intellectual property against others;

indemnify customer or distributors;

pay substantial damages to our customers or end users to discontinue use or replace infringing technology with non-infringing technology; or

Edgar Filing: Avago Technologies LTD - Form 10-Q

relinquish intellectual property rights associated with one or more of our patent claims, if such claims are held invalid or otherwise unenforceable.

Any of the foregoing results could have a material adverse effect on our business, financial condition and results of operations.

We utilize a significant amount of intellectual property in our business. If we are unable to protect our intellectual property, our business could be adversely affected.

Our success depends in part upon our ability to protect our intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including patents, mask works, copyrights, trademarks, service marks, trade secrets and similar intellectual property, as well as customary contractual protections with our customers, suppliers, employees and consultants, and through security measures to protect our trade secrets. We are unable to predict that:

any of the patents and pending patent applications that we presently employ in our business will not lapse or be invalidated, circumvented, challenged, abandoned or, in the case of third-party patents licensed or sub-licensed to us, be licensed to others;

our intellectual property rights will provide competitive advantages to us;

rights previously granted by third parties to intellectual property rights licensed or assigned to us, including portfolio cross-licenses, will not hamper our ability to assert our intellectual property rights against potential competitors or hinder the settlement of currently pending or future disputes;

Table of Contents

any of our pending or future patent applications will be issued or have the coverage originally sought;

our intellectual property rights will be enforced in certain jurisdictions where competition may be intense or where legal protection may be weak;

any of the trademarks, copyrights, mask work rights, trade secrets, know-how or other intellectual property rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged, abandoned or licensed to others; or

any of our pending or future trademark or copyright applications will be issued or have the coverage originally sought.

In addition, our competitors or others may develop products or technologies that are similar or superior to our products or technologies, duplicate our products or technologies or design around our protected technologies. Effective patent, trademark, copyright and trade secret protection may be unavailable or more limited in one or more relevant jurisdictions, relative to those protections available in the United States, or may not be applied for in one or more relevant jurisdictions. Moreover, from time to time we pursue litigation to assert our intellectual property rights and third parties may pursue litigation against us. An adverse decision in any of these legal actions could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business, financial condition and results of operations.

We have a number of patent and intellectual property license agreements. Some of these license agreements require us to make one-time or periodic payments. We may need to obtain additional patent licenses or renew existing license agreements in the future. We are unable to predict whether these license agreements can be obtained or renewed on acceptable terms or at all.

Competition in our industry could prevent us from growing our revenue and from raising prices to offset increases in costs.

The global semiconductor market is highly competitive. We compete in different target markets to various degrees on the basis of, among other things, quality, technical performance, price, product features, product system compatibility, system-level design capability, engineering expertise, responsiveness to customers, new product innovation, product availability, delivery timing and reliability, and customer sales and technical support. Current and prospective customers for our products evaluate our capabilities against the merits of our direct competitors. Some of our competitors are well established, have a more extensive product portfolio, have substantially greater market share and manufacturing, financial, research and development and marketing resources to pursue development, engineering, manufacturing, marketing and distribution of their products. In addition, many of our competitors have longer independent operating histories, greater presence in key markets, more comprehensive patent protection and greater name recognition. We compete with integrated device manufacturers, or IDMs, and fabless semiconductor companies as well as the internal resources of large, integrated OEMs. Our competitors range from large, international companies offering a wide range of semiconductor products to smaller companies specializing in narrow markets. We expect competition in the markets in which we participate to continue to increase as existing competitors improve or expand their product offerings. In addition, companies not currently in direct competition with us may introduce competing products in the future. Because our products are often building block semiconductors providing functions that in some cases can be integrated into more complex integrated circuits, or ICs, we also face competition from manufacturers of ICs, as well as customers that develop their own IC products. The competitive landscape is changing as a result of an increasing trend of consolidation within the industry, as some of our competitors have merged with or been acquired by other competitors while others have begun collaborating with each other. We expect this consolidation trend to continue.

Our ability to compete successfully depends on elements both within and outside of our control, including industry and general economic trends. During past periods of downturns in our industry, competition in the markets in which we operate intensified as manufacturers of semiconductors reduced prices in order to combat production overcapacity and high inventory levels. Many of our competitors have substantially greater financial and other resources with which to withstand similar adverse economic or market conditions in the future.

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

The semiconductor industry requires substantial investment in research and development in order to develop and bring to market new and enhanced technologies and products. In order to remain competitive, we anticipate that we will need to maintain or increase our levels of research and development expenditures, and we expect research and development expenses to increase in absolute dollars for the foreseeable future, due to the increasing complexity and number of products we plan to develop. We do not know whether we will have sufficient resources to maintain or increase the level of investment in research and development required to remain competitive. In addition, we cannot assure you

Edgar Filing: Avago Technologies LTD - Form 10-Q

that the technologies where we have focused our research and development expenditures will become commercially successful. If we are required to invest significantly greater resources than anticipated in our research and development efforts without a corresponding increase in revenue, our operating results could decline.

Table of Contents

Our business would be adversely affected by the departure of existing members of our senior management team or if our senior management team is unable to effectively implement our strategy.

Our success depends, in large part, on the continued contributions of our senior management team, in particular, the services of Mr. Hock E. Tan, our President and Chief Executive Officer. None of our senior management is bound by written employment contracts to remain with us for a specified period. In addition, we do not currently maintain key person life insurance covering our senior management. The loss of any of our senior management could harm our ability to implement our business strategy and respond to the rapidly changing market conditions in which we operate.

If we are unable to attract, train and retain qualified personnel, especially our design and technical personnel, we may not be able to execute our business strategy effectively.

Our future success depends on our ability to retain, attract and motivate qualified personnel, including our management, sales and marketing, legal and finance, and especially our design and technical personnel. We do not know whether we will be able to retain all of these employees as we continue to pursue our business strategy. We have historically encountered difficulties in hiring and retaining qualified engineers because there is a limited pool of engineers with expertise in analog and optoelectronic semiconductor design. Competition for such personnel is intense in the semiconductor industry. As the source of our technological and product innovations, our design and technical personnel represent a significant asset. The loss of the services of key employees, especially our key design and technical personnel, or our inability to retain, attract and motivate qualified design and technical personnel, could have a material adverse effect on our business, financial condition and results of operations.

We are subject to warranty claims, product recalls and product liability.

We are currently, and from time to time may be, subject to warranty or product liability claims that have lead and may in the future lead to significant expenses as we compensate affected customers to defend such claims or pay damage awards. For example, in the second quarter of 2009 we identified a product quality issue with a particular component that we took steps to correct, including notifying our customers and offering to replace such components. We are currently in discussions with affected customers regarding this issue, and have compensated or otherwise rectified the issue with many of those customers. To date we have recorded \$11 million in charges associated with this issue, and may incur additional charges as we continue to work with our customers to resolve the matter. Although we maintain product liability insurance, such insurance is subject to significant deductibles and there is no guarantee that such insurance will be available or adequate to protect against all such claims, or we may elect to self-insure with respect to certain matters. We may incur costs and expenses in the event of any recall of a customer's product containing one of our devices. The process of identifying a recalled product in devices that have been widely distributed may be lengthy and require significant resources, and we may incur significant replacement costs, contract damage claims from our customers and reputational harm. Costs or payments made in connection with warranty and product liability claims and product recalls could materially affect our financial condition and results of operations.

The complexity of our products could result in unforeseen delays or expenses or undetected defects or bugs, which could adversely affect the market acceptance of new products, damage our reputation with current or prospective customers, and materially and adversely affect our operating costs.

Highly complex products such as the products that we offer, may contain defects and bugs when they are first introduced or as new versions are released. We have in the past experienced, and may in the future experience, these defects and bugs. If any of our products contain defects or bugs, or have reliability, quality or compatibility problems, we may not be able to successfully design workarounds. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could materially and adversely affect our ability to retain existing customers, attract new customers, and our financial results. In addition, these defects or bugs could interrupt or delay sales to our customers. To resolve these problems, we may have to invest significant capital and other resources. Although our products are tested by our suppliers, our customers and ourselves, it is possible that our new products will contain defects or bugs. If any of these problems are not found until after we have commenced commercial production of a new product, we may be required to incur additional development costs and product recall, repair or replacement costs. These problems may also result in claims against us by our customers or others. In addition, these problems may divert our technical and other resources from other development efforts, we would likely lose, or experience a delay in, market acceptance of the affected product or products, and we could lose credibility with our current and prospective customers. As a result, our financial results could be materially and adversely affected.

Table of Contents

Failure to adjust our supply chain volume due to changing market conditions or failure to estimate our customers' demand could adversely affect our results of operations.

We make significant decisions, including determining the levels of business that we will seek and accept, production schedules, levels of reliance on contract manufacturing and outsourcing, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of rapid changes in demand for their products reduces our ability to accurately estimate future customer requirements. Our results of operations could be harmed if we are unable to adjust our supply chain volume to address market fluctuations, including those caused by the seasonal or cyclical nature of the markets in which we operate. The sale of our products is dependent, to a large degree, on customers whose industries are subject to seasonal or cyclical trends in the demand for their products. For example, the consumer electronics market is particularly volatile and is subject to seasonality related to the holiday selling season, making demand difficult to anticipate. On occasion, customers may require rapid increases in production, which can challenge our resources and reduce margins. During a market upturn, we may not be able to purchase sufficient supplies or components, or secure sufficient contract manufacturing capacity, to meet increasing product demand, which could harm our reputation, prevent us from taking advantage of opportunities and reduce revenue growth. In addition, some parts are not readily available from alternate suppliers due to their unique design or the length of time necessary for design work.

In order to secure components for the production of products, we may continue to enter into non-cancelable purchase commitments with vendors or make advance payments to suppliers, which could reduce our ability to adjust our inventory or expense levels to declining market demands. Prior commitments of this type have resulted in an excess of parts when demand for our products has decreased. Downturns in the semiconductor industry have in the past caused, and may in the future cause, our customers to reduce significantly the amount of products ordered from us. If demand for our products is less than we expect, we may experience excess and obsolete inventories and be forced to incur additional charges. Because certain of our sales, research and development and internal manufacturing overhead expenses are relatively fixed, a reduction in customer demand may decrease our gross margins and operating income.

Our operating results and financial condition could be harmed if the markets into which we sell our products decline.

Visibility into our markets is limited. As has been the case in the recent economic downturn, any decline in our customers' markets would likely result in a reduction in demand for our products and make it more difficult to collect on outstanding amounts due us. For example, if the Asian market does not grow as anticipated or if the semiconductor market continues to decline, our results of operations will likely continue to suffer. In such an environment, pricing pressures could intensify and, if we were unable to respond quickly, could significantly reduce our gross margins. To the extent we cannot offset recessionary periods or periods of reduced growth that may occur in these markets through increased market share or otherwise, our net revenue may decline and our business, financial condition and results of operations may suffer. Pricing pressures and competition are especially intense in semiconductor-related industries, which could prevent achievement of our long-term financial goals and could require us to implement additional cost-cutting measures. Furthermore, projected industry growth rates may not be as forecasted, which could result in spending on process and product development well ahead of market requirements, which could have a material adverse effect on our business, financial condition and results of operations.

The demands or loss of one or more of our significant customers may adversely affect our business.

Some of our customers are material to our business and results of operations. During the fiscal quarter ended January 31, 2010, one customer accounted for 10% or more of our net revenue from continuing operations, and our top 10 customers, which included four distributors, collectively accounted for 59% of our net revenue from continuing operations. During the fiscal year ended November 1, 2009, no customer accounted for 10% or more of our net revenue from continuing operations, and our top 10 customers, which included four distributors, collectively accounted for 60% of our net revenue from continuing operations. We believe our top customers' purchasing power has given them the ability to make greater demands on their suppliers, including us. We expect this trend to continue, which we expect will result in our results of operations becoming increasingly sensitive to deterioration in the financial condition of, or other adverse developments related to, one or more of our significant customers. Although we believe that our relationships with our major customers are good, we generally do not have long-term contracts with any of them, which is typical of our industry. As a result, although our customers provide indications of their product needs and purchases on an annual basis, they generally purchase our products on a weekly or daily basis and the relationship, as well as particular orders, can be terminated at any time. The loss of any of our major customers, or any substantial reduction in sales to any of these customers, could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

We generally do not have any long-term supply contracts with our contract manufacturers or materials suppliers and may not be able to obtain the products or raw materials required for our business, which could have a material adverse effect on our business.

We either obtain the products we need for our business from third-party contract manufacturers or we obtain the materials we need for our products from suppliers. We purchase a significant portion of our semiconductor materials from a few suppliers. For the fiscal quarter ended January 31, 2010, we purchased 51% of the materials for our manufacturing processes from eight suppliers. For the fiscal year ended November 1, 2009, we purchased 52% of the materials for our manufacturing processes from eight suppliers. Substantially all of our purchases are on a purchase order basis, and we have not generally entered into long-term contracts with our contract manufacturers or suppliers. In the event that these purchase orders or relationships with suppliers are terminated, we cannot obtain sufficient quantities of raw materials at reasonable prices, the quality of the material deteriorates, we fail to satisfy our customers' requirements or we are not able to pass on higher materials costs to our customers, our business, financial condition and results of operations could be adversely impacted. For example, during fiscal year 2008, we experienced an increase in our cost of products sold as a result of higher energy costs.

Our manufacturing processes rely on many materials, including silicon and GaAs wafers, copper lead frames, mold compound, ceramic packages and various chemicals and gases. From time to time, suppliers may extend lead times, limit supplies or increase prices due to capacity constraints or other factors. Although we believe that our current supplies of materials are adequate, shortages could occur in various essential materials due to interruption of supply or increased demand in the industry.

We use third-party contractor manufacturers for most of our manufacturing activities, primarily for wafer fabrication and module assembly and test services. Our agreements with these manufacturers typically require us to forecast product needs, commit to purchase services consistent with these forecasts and may require other commitments in the early stages of the relationship. Our operations could be adversely affected in the event that these contractual relationships were disrupted or terminated, the cost of such services increased significantly, the quality of the services provided deteriorated, our forecasts proved to be materially incorrect or capacity is consumed by our competitors.

We rely on third parties to provide services necessary for the operation of our business. Any failure of one or more of our vendors to provide these services could have a material adverse effect on our business.

We rely on third-party vendors to provide critical services, including, among other things, certain services related to accounting, billing, human resources, information technology, or IT, network development and network monitoring. We depend on these vendors to ensure that our corporate infrastructure will consistently meet our business requirements. The ability of these third-party vendors to successfully provide reliable, high quality services is subject to technical and operational uncertainties that are beyond our control. While we may be entitled to damages if our vendors fail to perform under their agreements with us, our agreements with these vendors limit the amount of damages we may receive. In addition, we do not know whether we will be able to collect on any award of damages or that any such damages would be sufficient to cover the actual costs we would incur as a result of any vendor's failure to perform under its agreement with us. Any failure of our corporate infrastructure could have a material adverse effect on our business, financial condition and results of operations. Upon expiration or termination of any of our agreements with third-party vendors, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, that are favorable to us and a transition from one vendor to another vendor could subject us to operational delays and inefficiencies until the transition is complete.

Our gross margin is dependent on a number of factors, including our product mix and level of capacity utilization.

Our gross margin is highly dependent on product mix, with proprietary products typically providing higher gross margin than other products. A shift in sales mix away from our higher margin products could adversely affect the Company's future gross margin percentages. In addition, semiconductor manufacturing requires significant capital investment, leading to high fixed costs, including depreciation expense. Although we outsource a significant portion of our manufacturing activities, we do retain some semiconductor fabrication and assembly and test facilities. If we are unable to utilize our owned fabrication and assembly and test facilities at a high level, the fixed costs associated with these facilities will not be fully absorbed, resulting in higher average unit costs and lower gross margins. In the past, we have experienced periods where our gross margins declined due to, among other things, reduced factory utilization resulting from reduced customer demand, reduced selling prices and a change in product mix towards lower margin devices. Increased competition and the existence of product alternatives, more complex engineering requirements, lower demand and other factors may lead to further price erosion, lower revenues and lower margins for us in the future.

Table of Contents

Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business and other factors related to our international operations.

We sell our products throughout the world. In addition, approximately 66% of our employees are located outside of the United States. Multiple factors relating to our international operations and to particular countries in which we operate could have a material adverse effect on our business, financial condition and results of operations. These factors include:

changes in political, regulatory, legal or economic conditions;

restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments and trade protection measures, including export duties and quotas and customs duties and tariffs;

disruptions of capital and trading markets;

changes in import or export licensing requirements;

transportation delays;

civil disturbances or political instability;

geopolitical turmoil, including terrorism, war or political or military coups;

changes in labor standards;

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

nationalization of businesses and expropriation of assets;

changes in tax laws;

currency fluctuations, which may result in our products becoming too expensive for foreign customers or foreign-sourced materials and services becoming more expensive for us; and

difficulty in obtaining distribution and support.

International conflicts are creating many economic and political uncertainties that are impacting the global economy. A continued escalation of international conflicts could severely impact our operations and demand for our products.

Edgar Filing: Avago Technologies LTD - Form 10-Q

A majority of our products are produced and sourced in Asia, primarily in Singapore, Malaysia and Taiwan. Any conflict or uncertainty in these countries, including due to public health or safety concerns could have a material adverse effect on our business, financial condition and results of operations. In addition, if the government of any country in which our products are manufactured or sold sets technical standards for products manufactured in or imported into their country that are not widely shared, it may lead certain of our customers to suspend imports of their products into that country, require manufacturers in that country to manufacture products with different technical standards and disrupt cross-border manufacturing relationships which, in each case, could have a material adverse effect on our business, financial condition and results of operations.

In addition, our subsidiaries may require future equity-related financing, and any capital contributions to certain of our subsidiaries may require the approval of the relevant authorities in the jurisdiction in which the subsidiary is incorporated. The approvals are required from the investment commissions or similar agency of the particular jurisdiction and relate to any initial or additional equity investment by foreign entities in local corporations. Our failure to obtain the required approvals and our resulting inability to provide such equity-related financing or capital contributions could have an adverse effect on our business, financial condition and results of operations.

We are subject to currency exchange risks that could adversely affect our operations.

Although a majority of our revenue and operating expenses is denominated in U.S. dollars, and we prepare our financial statements in U.S. dollars in accordance with generally accepted accounting principles, or GAAP, a portion of our revenue and operating expenses is in foreign currencies. As a result, we are subject to currency risks that could adversely affect our operations, including:

risks resulting from changes in currency exchange rates and the implementation of exchange controls; and

limitations on our ability to reinvest earnings from operations in one country to fund the capital needs of our operations in other countries.

Changes in exchange rates will result in increases or decreases in our costs and earnings, and may also affect the book value of our assets located outside the United States and the amount of our equity. Although we seek to minimize our currency exposure by engaging in hedging transactions where we deem it appropriate, we do not know whether our efforts will be successful.

Table of Contents

If we suffer loss to our factories, facilities or distribution system due to catastrophe, our operations could be seriously harmed.

Our factories, facilities and distribution system, and those of our contract manufacturers, are subject to risk of catastrophic loss due to fire, flood, or other natural or man-made disasters. A number of our facilities and those of our contract manufacturers are located in areas with above average seismic activity. Any catastrophic loss to any of these facilities would likely disrupt our operations, delay production, shipments and revenue and result in significant expenses to repair or replace the facility. In particular, any catastrophic loss at our Fort Collins, Colorado and Singapore facilities would materially and adversely affect our business.

If the tax incentive or tax holiday arrangements we have negotiated in Singapore and other jurisdictions change or cease to be in effect or applicable, or if our assumptions and interpretations regarding tax laws and incentive or holiday arrangements prove to be incorrect, the amount of corporate income taxes we have to pay could significantly increase.

We have structured our operations to maximize the benefit from various tax incentives and tax holidays extended to us in various jurisdictions to encourage investment or employment. For example, we have obtained several tax incentives from the Singapore Economic Development Board, an agency of the Government of Singapore, which provide that certain classes of income we earn in Singapore are subject to tax holidays or reduced rates of Singapore income tax. Each such tax incentive is separate and distinct from the others, and may be granted, withheld, extended, modified, truncated, complied with or terminated independently without any effect on the other incentives. In order to retain these tax benefits in Singapore, we must meet certain operating conditions specific to each incentive relating to, among other things, maintenance of a treasury function, a corporate headquarters function, specified intellectual property activities and specified manufacturing activities in Singapore. Some of these operating conditions are subject to phase-in periods through 2015. The Singapore tax incentives are presently scheduled to expire at various dates generally between 2012 and 2015, subject in certain cases to potential extensions. Absent such tax incentives, the corporate income tax rate in Singapore would be 17% commencing from the 2010 year of assessment. For the fiscal years ended October 31, 2007, November 2, 2008 and November 1, 2009, the effect of all these tax incentives, in the aggregate, was to reduce the overall provision for income taxes from what it otherwise would have been in such year by approximately \$19 million, \$24 million and \$17 million, respectively. The tax incentives that we have negotiated in other jurisdictions are also subject to our compliance with various operating and other conditions. If we cannot or elect not to comply with the operating conditions included in any particular tax incentive, we will lose the related tax benefits and could be required to refund material tax benefits previously realized by us with respect to that incentive and, depending on the incentive at issue, could likely be required to modify our operational structure and tax strategy. Any such modified structure or strategy may not be as beneficial to us from an income tax expense or operational perspective as the benefits provided under the present tax concession arrangements.

Our interpretations and conclusions regarding the tax incentives are not binding on any taxing authority, and if our assumptions about tax and other laws are incorrect or if these tax incentives are substantially modified or rescinded we could suffer material adverse tax and other financial consequences, which would increase our expenses, reduce our profitability and adversely affect our cash flows. In addition, taxable income in any jurisdiction is dependent upon acceptance of our operational practices and intercompany transfer pricing by local tax authorities as being on an arm's length basis. Due to inconsistencies in application of the arm's length standard among taxing authorities, as well as lack of adequate treaty-based protection, transfer pricing challenges by tax authorities could, if successful, substantially increase our income tax expense.

The enactment of legislation implementing changes in U.S. taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.

Several tax bills have been introduced to reform U.S. taxation of international business activities. Depending on the final form of legislation enacted, if any, these consequences may be significant for us due to the large scale of our international business activities. If any of these proposals are enacted into legislation, they could have material adverse consequences on the amount of tax we pay and thereby on our financial position and results of operations.

We may pursue acquisitions, dispositions, investments and joint ventures, which could affect our results of operations.

We have disposed of significant portions of the business originally acquired from Agilent through the sales of our Storage Business, our Printer ASICs Business and our Image Sensor operations in 2006, and the sale of our Infra-red operations in 2008. We may seek additional opportunities to maximize efficiency and value through various transactions, including purchases or sales of assets, businesses, investments or contractual arrangements. These transactions may be intended to result in the reduction of our indebtedness, the realization of cost savings, the generation of cash or income or the reduction of risk. These transactions may also affect our consolidated results of operations.

We have made and expect to continue to make acquisitions of, and investments in, businesses that offer complementary products, services and technologies, augment our market coverage, or enhance our technological capabilities. We may also enter into strategic alliances or joint ventures to achieve these goals. We cannot assure you that we will be able to identify suitable acquisition, investment, alliance, or joint venture

Edgar Filing: Avago Technologies LTD - Form 10-Q

opportunities or that we will be able to consummate any such transactions or relationships on terms and conditions acceptable to us, or that such transactions or relationships will be successful.

Table of Contents

These transactions or any other acquisitions or dispositions involve risks and uncertainties. For example, the integration of acquired businesses may not be successful and could result in disruption to other parts of our business. In addition, the integration may require that we incur significant restructuring charges. To integrate acquired businesses, we must implement our management information systems, operating systems and internal controls, and assimilate and manage the personnel of the acquired operations. The difficulties of the integrations may be further complicated by such factors as geographic distances, lack of experience operating in the geographic market or industry sector of the acquired business, delays and challenges associated with integrating the business with our existing businesses, diversion of management's attention from daily operations of the business, potential loss of key employees and customers of the acquired business, the potential for deficiencies in internal controls at the acquired or combined business, performance problems with the acquired business's technology, difficulties in entering markets in which we have no or limited direct prior experience, exposure to unanticipated liabilities of the acquired business, insufficient revenues to offset increased expenses associated with the acquisition, and our potential inability to achieve the growth prospects and synergies expected from any such acquisition. Even when an acquired business has already developed and marketed products, there can be no assurance that product enhancements will be made in a timely fashion or that all pre-acquisition due diligence will have identified all material issues that might arise with respect to such acquired assets.

Any acquisition may also cause us to assume liabilities, acquire goodwill and non-amortizable intangible assets that will be subject to impairment testing and potential impairment charges, incur amortization expense related to certain intangible assets, increase our expenses and working capital requirements, and subject us to litigation, which would reduce our return on invested capital. Failure to manage and successfully integrate the acquisitions we make could materially harm our business and operating results.

Any future acquisitions may require additional debt or equity financing, which, in the case of debt financing, would increase our leverage and potentially affect our credit ratings, and in the case of equity financing, would be dilutive to our existing shareholders. Any downgrades in our credit ratings associated with an acquisition could adversely affect our ability to borrow by resulting in more restrictive borrowing terms. As a result of the foregoing, we also may not be able to complete acquisitions or strategic customer transactions in the future to the same extent as in the past, or at all. These and other factors could harm our ability to achieve anticipated levels of profitability at acquired operations or realize other anticipated benefits of an acquisition, and could adversely affect our business, financial condition and results of operations.

Our business is subject to various governmental regulations, and compliance with these regulations may cause us to incur significant expenses. If we fail to maintain compliance with applicable regulations, we may be forced to recall products and cease their manufacture and distribution, and we could be subject to civil or criminal penalties.

Our business is subject to various significant international and U.S. laws and other legal requirements, including packaging, product content, labor and import/export regulations. These regulations are complex, change frequently and have generally become more stringent over time. We may be required to incur significant expenses to comply with these regulations or to remedy violations of these regulations. Any failure by us to comply with applicable government regulations could result in cessation of our operations or portions of our operations, product recalls or impositions of fines and restrictions on our ability to conduct our operations. In addition, because many of our products are regulated or sold into regulated industries, we must comply with additional regulations in marketing our products.

Our products and operations are also subject to the rules of industrial standards bodies, like the International Standards Organization, as well as regulation by other agencies, such as the U.S. Federal Communications Commission. If we fail to adequately address any of these rules or regulations, our business could be harmed.

We must conform the manufacture and distribution of our semiconductors to various laws and adapt to regulatory requirements in all countries as these requirements change. If we fail to comply with these requirements in the manufacture or distribution of our products, we could be required to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products commercially until the products or component substances are brought into compliance.

We are subject to environmental, health and safety laws, which could increase our costs, restrict our operations and require expenditures that could have a material adverse effect on our results of operations and financial condition.

We are subject to a variety of international and U.S. laws and other legal requirements relating to the use, disposal, clean-up of and human exposure to, hazardous materials. Any failure by us to comply with environmental, health and safety requirements could result in the limitation or suspension of production or subject us to future liabilities in excess of our reserves. In addition, compliance with environmental, health and safety requirements could restrict our ability to expand our facilities or require us to acquire costly pollution control equipment, incur other significant expenses or modify our manufacturing processes. In the event of the discovery of new contamination, additional requirements with respect to existing contamination, or the imposition of other cleanup obligations for which we are responsible, we may be required to take remedial or other measures which could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

We also face increasing complexity in our product design and procurement operations as we adjust to new requirements relating to the materials composition of our products, including the restrictions on lead and certain other substances in electronics that apply to specified electronics products sold in the European Union as of July 1, 2006 under the Restriction of Hazardous Substances in Electrical and Electronic Equipment Directive. Other countries, such as the United States, China and Japan, have enacted or may enact laws or regulations similar to the EU legislation. Other environmental regulations may require us to reengineer our products to utilize components that are more environmentally compatible. Such reengineering and component substitution may result in excess inventory or other additional costs and could have a material adverse effect on our results of operations.

In addition to the costs of complying with environmental, health and safety requirements, we may in the future incur costs defending against environmental litigation brought by government agencies and private parties. We may be defendants in lawsuits brought by parties in the future alleging environmental damage, personal injury or property damage. A significant judgment against us could harm our business, financial condition and results of operations.

In the last few years, there has been increased media scrutiny and associated reports focusing on a potential link between working in semiconductor manufacturing clean room environments and certain illnesses, primarily different types of cancers. Regulatory agencies and industry associations have begun to study the issue to see if any actual correlation exists. Because we utilize clean rooms, we may become subject to liability claims. In addition, these reports may also affect our ability to recruit and retain employees.

We cannot predict:

changes in environmental or health and safety laws or regulations;

the manner in which environmental or health and safety laws or regulations will be enforced, administered or interpreted;

our ability to enforce and collect under indemnity agreements and insurance policies relating to environmental liabilities; or

the cost of compliance with future environmental or health and safety laws or regulations or the costs associated with any future environmental claims, including the cost of clean-up of currently unknown environmental conditions.

We may not realize the expected benefits of our recent restructuring activities and other initiatives designed to reduce costs and increase revenue across our operations.

We recently have pursued a number of restructuring initiatives designed to reduce costs and increase revenue across our operations. These initiatives included significant workforce reductions in certain areas as we realigned our business. Additional initiatives included establishing certain operations closer in location to our global customers, evaluating functions more efficiently performed through partnerships or other outside relationships and steps to attempt to further reduce our overhead costs. We may not realize the expected benefits of these initiatives. As a result of these initiatives, we have incurred restructuring or other infrequent charges and we may in the future experience disruptions in our operations, loss of key personnel and difficulties in delivering products timely. In the fiscal quarter ended January 31, 2010 and in the fiscal year ended November 1, 2009, we incurred restructuring charges of \$1 million and \$34 million, respectively, consisting primarily of employee severance and related costs resulting from a reduction in our workforce.

We are subject to risks associated with our distributors product inventories and product sell-through.

We sell many of our products to customers through distributors who maintain their own inventory of our products for sale to dealers and end users. We recognize revenues for sales to distributors upon delivery to the distributor. We limit distributor return rights and we allow limited price adjustments on sales to distributors. We provide reserves for distributor rights related to these limited stock returns and price adjustments. Sales to distributors accounted for 40% and 33% of our net revenue from continuing operations for the fiscal quarter ended January 31, 2010 and the fiscal year ended November 1, 2009, respectively.

If these distributors are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end users or if they decide to decrease their inventories for any reason, such as due to the current global recession or due to any downturn in technology spending,

Edgar Filing: Avago Technologies LTD - Form 10-Q

our sales to these distributors and our revenues may decline. In addition, if distributors decide to purchase more inventory in any particular quarter, due to product availability or other reasons, than is required to satisfy end customer demand, inventory at our distributors may grow in such quarter, which could adversely affect our product revenues in a subsequent quarter as such distributors will likely reduce future orders until their inventory levels realign with end customer demand. For example, during the fiscal year ended November 1, 2009, and in particular during the first fiscal quarter of that year, the semiconductor industry experienced a significant decline in demand. Consequently, our distributors experienced declines in their resales of our products and were carrying a higher level of inventories of our products than historical levels at the end of the first quarter of fiscal year 2009. As a result, our distributors decided to reduce their inventory of our products during the second fiscal quarter of 2009 and we also reduced our own inventory by \$27 million or 15% in that quarter.

Table of Contents

We also face the risk that our distributors may for other reasons have inventory levels of our products in excess of future anticipated sales. If such sales do not occur in the time frame anticipated by these distributors for any reason, these distributors may substantially decrease the amount of product they order from us in subsequent periods, which would harm our business.

Our reserve estimates associated with products stocked by our distributors are based largely on reports that our distributors provide to us on a monthly basis. To date, we believe this data has been generally accurate. To the extent that this resale and channel inventory data is inaccurate or not received in a timely manner, we may not be able to make reserve estimates for future periods accurately or at all.

We rely on third-party distributors and manufacturers representatives and the failure of these distributors and manufacturers representatives to perform as expected could reduce our future sales.

We sell many of our products to customers through distributors and manufacturers representatives. We are unable to predict the extent to which our distributors and manufacturers representatives will be successful in marketing and selling our products. Moreover, many of our distributors and manufacturers representatives and distributors also market and sell competing products. Our representatives and distributors may terminate their relationships with us at any time. Our future performance will also depend, in part, on our ability to attract additional distributors or manufacturers representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain our current distributors or manufacturers representatives or recruit additional or replacement distributors or manufacturers representatives, our sales and operating results will be harmed.

The average selling prices of products in our markets have historically decreased rapidly and will likely do so in the future, which could harm our revenues and gross profits.

The products we develop and sell are used for high volume applications. As a result, the prices of those products have historically decreased rapidly. We expect that our gross profits on our products are likely to decrease over the current fiscal year below levels we have historically experienced due to pricing pressures from our customers, and an increase in sales of wireless and other products into consumer application markets, which are highly competitive and cost sensitive. In the past, we have reduced the average selling prices of our products in anticipation of future competitive pricing pressures, new product introductions by us or our competitors and other factors. Our gross profits and financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing manufacturing costs, or developing new and higher value-added products on a timely basis.

We are required to assess our internal control over financial reporting on an annual basis and any adverse findings from such assessment could result in a loss of investor confidence in our financial reports, significant expenses to remediate any internal control deficiencies and ultimately have an adverse effect on our share price.

We are required to assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. As required, we complied with Section 404(a) (management's report on internal control over financial reporting) under the Sarbanes-Oxley Act of 2002, as amended, or the Sarbanes-Oxley Act, for the fiscal year ended November 1, 2009, and we will be required to comply with Section 404(b) (auditor's attestation on management's report) for the fiscal year ending October 31, 2010. The testing by our independent registered public accounting firm that must be performed for the fiscal year ending on October 31, 2010, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. If we fail to implement the requirements of Section 404 in a timely manner, we might be subject to sanctions or investigation by regulatory agencies such as the SEC. In addition, failure to comply with Section 404 or the disclosure by us of a material weakness may cause investors to lose confidence in our financial statements and the trading price of our ordinary shares may decline.

Remediation of a material weakness could require us to incur significant expense and if we fail to remedy any material weakness, our financial statements may be inaccurate, our ability to report our financial results on a timely and accurate basis may be adversely affected, our access to the capital markets may be restricted, the trading price of our ordinary shares may decline, and we may be subject to sanctions or investigation by regulatory authorities, including the SEC or the Nasdaq Global Select Market. We may also be required to restate our financial statements from prior periods.

Table of Contents

Our indebtedness could adversely affect our financial health and our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate indebtedness and prevent us from fulfilling our obligations under our indebtedness.

The following table presents our long-term indebtedness and capital lease obligations as of January 31, 2010 and November 1, 2009:

	November 1, 2009	As of January 31, 2010 (in millions)
10 ¹ / ₈ % senior notes due 2013	\$ 318	\$
Senior floating rate notes due 2013	46	
11 ⁷ / ₈ % senior subordinated notes due 2015	230	230
Long-term obligation for capital leases	3	2
	597	232
Less: Current portion of long-term debt	364	
Total long-term indebtedness	\$ 233	\$ 232

In addition, we had \$15 million and \$17 million, respectively, of letters of credit outstanding under our revolving credit facility.

In the fourth quarter of fiscal year 2009, we repurchased an aggregate of \$106 million principal amount of our outstanding notes, consisting of \$85 million principal amount of our 10 ¹/₈% senior notes due 2013, or senior fixed rate notes, \$17 million principal amount of our 11 ⁷/₈% senior subordinated notes due 2015, or senior subordinated notes, and \$4 million principal amount of our senior floating rate notes due 2013, or senior floating rate notes, pursuant to a cash tender offer.

In addition, on December 1, 2009, we redeemed an aggregate of \$364 million principal amount of our outstanding notes, consisting of the remaining \$318 million principal amount of our senior fixed rate notes and the remaining \$46 million principal amount of our senior floating rate notes, pursuant to the terms of our indenture governing such notes.

Subject to restrictions in the indenture governing our senior subordinated notes and our senior credit agreement, we may incur additional indebtedness. We are currently able to borrow up to an additional \$335 million under our revolving credit facility. Furthermore, borrowings under our senior credit agreement are secured by substantially all of our assets.

While we have recently significantly reduced the amount of our indebtedness, if we were to borrow substantial amounts under our revolving credit facility or otherwise incur significant additional indebtedness, it could have important consequences including:

making it more difficult for us to satisfy our obligations with respect to our senior subordinated notes, including our repurchase obligations;

increasing our vulnerability to adverse general economic and industry conditions;

requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, execution of our business strategy and other general corporate purposes;

Edgar Filing: Avago Technologies LTD - Form 10-Q

limiting our flexibility in planning for, or reacting to, changes in the economy and the semiconductor industry;

placing us at a competitive disadvantage compared to our competitors with less indebtedness;

exposing us to interest rate risk to the extent of our variable rate indebtedness;

limiting our ability to, or increasing the costs to, refinance indebtedness; and

making it more difficult to borrow additional funds in the future to fund working capital, capital expenditures and other purposes. Any of the foregoing could materially and adversely affect our business, financial conditions and results of operations.

The indenture governing our senior subordinated notes and our senior credit agreement impose significant restrictions on our business.

The indenture governing our senior subordinated notes and the senior credit agreement contain a number of covenants imposing significant restrictions on our business. These restrictions may affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise. The restrictions placed on us include limitations on our ability and the ability of our subsidiaries to:

incur additional indebtedness and issue ordinary or preferred shares;

Table of Contents

pay dividends or make other distributions on, redeem or repurchase our shares or make other restricted payments;

make investments, acquisitions, loans or advances;

incur or create liens;

transfer or sell certain assets;

engage in sale and lease back transactions;

declare dividends or make other payments to us;

guarantee indebtedness;

engage in transactions with affiliates; and

consolidate, merge or transfer all or substantially all of our assets.

In addition, over a specified limit, our senior credit agreement requires us to meet a financial ratio test and restricts our ability to make capital expenditures or prepay certain other indebtedness. Our ability to meet the financial ratio test may be affected by events beyond our control, and we do not know whether we will be able to maintain this ratio.

The foregoing restrictions could limit our ability to plan for, or react to, changes in market conditions or our capital needs. We do not know whether we will be granted waivers under, or amendments to, our senior credit agreement or the indenture if for any reason we are unable to meet these requirements, or whether we will be able to refinance our indebtedness on terms acceptable to us, or at all.

The breach of any of these covenants or restrictions could result in a default under the indenture governing our senior subordinated notes or our senior credit agreement. In addition, our senior credit agreement and our indenture contain cross-default provisions which could thereby result in an acceleration of amounts outstanding under all those debt instruments if certain events of default occur under any one of them. If we are unable to repay these amounts, lenders having secured obligations, including the lenders under our senior credit agreement, could proceed against the collateral securing that debt. Any of the foregoing would have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to Investments in Singapore Companies

It may be difficult to enforce a judgment of U.S. courts for civil liabilities under U.S. federal securities laws against us, our directors or officers in Singapore.

We are incorporated under the laws of the Republic of Singapore, and certain of our officers and directors are or will be residents outside the United States. Moreover, a majority of our consolidated assets are located outside the United States. Although we are incorporated outside the United States, we have agreed to accept service of process in the United States through our agent designated for that purpose. Nevertheless, since a majority of the consolidated assets owned by us are located outside the United States, any judgment obtained in the United States against us may not be collectible within the United States.

There is no treaty between the United States and Singapore providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters and a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not predicated solely upon the federal securities laws, would, therefore, not be automatically enforceable in Singapore.

Edgar Filing: Avago Technologies LTD - Form 10-Q

There is doubt whether a Singapore court may impose civil liability on us or our directors and officers who reside in Singapore in a suit brought in the Singapore courts against us or such persons with respect to a violation solely of the federal securities laws of the United States, unless the facts surrounding such a violation would constitute or give rise to a cause of action under Singapore law. Consequently, it may be difficult for investors to enforce against us, our directors or our officers in Singapore judgments obtained in the United States which are predicated upon the civil liability provisions of the federal securities laws of the United States.

We are incorporated in Singapore and our shareholders may have more difficulty in protecting their interest than they would as shareholders of a corporation incorporated in the United States.

Our corporate affairs are governed by our memorandum and articles of association and by the laws governing corporations incorporated in Singapore. The rights of our shareholders and the responsibilities of the members of our board of directors under Singapore law are different from those applicable to a corporation incorporated in the United States. Therefore, our public shareholders may have more difficulty in protecting their interest in connection with actions taken by our management, members of our board of directors or our controlling shareholder than they would as shareholders of a corporation incorporated in the United States. For example, controlling shareholders in U.S. corporations are subject to fiduciary duties while controlling shareholders in Singapore corporations are not subject to such duties.

Table of Contents

For a limited period of time, our directors have general authority to allot and issue new shares on terms and conditions and with any preferences, rights or restrictions as may be determined by our board of directors in its sole discretion.

Under Singapore law, we may only allot and issue new shares with the prior approval of our shareholders in a general meeting. At our 2009 annual general meeting of shareholders, our shareholders provided our directors with the general authority to allot and issue any number of new shares (whether as ordinary shares or preference shares) until the earlier of (i) the conclusion of our 2010 annual general meeting, (ii) the expiration of the period within which the next annual general meeting is required to be held (i.e., within 15 months from the conclusion of the last general meeting) or (iii) the subsequent revocation or modification of such general authority by our shareholders acting at a duly noticed and convened meeting. Subject to the general authority to allot and issue new shares provided by our shareholders, the provisions of the Singapore Companies Act and our memorandum and articles of association, our board of directors may allot and issue new shares on terms and conditions and with the rights (including preferential voting rights) and restrictions as they may think fit to impose. Any additional issuances of new shares by our directors may adversely impact the market price of our ordinary shares.

Risks Relating to Owning Our Ordinary Shares

Control by principal shareholders could adversely affect our other shareholders.

Investment funds affiliated with KKR and investment funds affiliated with Silver Lake together will beneficially own approximately 55% of our outstanding ordinary shares through their ownership of Bali Investments S.à.r.l, our principal shareholder, and Seletar Investments Pte Ltd, or Seletar, and Geysler Investment Pte Ltd., or Geysler, will beneficially own approximately 7% and 5% of our outstanding ordinary shares, respectively (based on the number of ordinary shares outstanding as of February 10, 2010). In addition, pursuant to the terms of our Second Amended and Restated Shareholder Agreement, or the Shareholder Agreement, KKR and Silver Lake together, the Sponsors, or their respective affiliates, and Seletar, can elect their respective designees to serve as members of our board of directors. These shareholders will have a continuing ability to control our board of directors and will continue to have significant influence over our affairs for the foreseeable future, including controlling the election of directors and significant corporate transactions, such as a merger or other sale of our company or our assets. In addition, under the controlled company exception to the independence requirements of the Nasdaq Global Select Market, we are presently exempt from the rules of the Nasdaq Global Select Market that require that our board of directors be comprised of a majority of independent directors, that our compensation committee be comprised solely of independent directors and that our nominating and governance committee be comprised solely of independent directors. This concentrated control will limit the ability of other shareholders to influence corporate matters and, as a result, we may take actions that our non-Sponsor shareholders do not view as beneficial. For example, this concentration of ownership could have the effect of delaying or preventing a change in control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could cause the market price of our ordinary shares to decline or prevent our shareholders from realizing a premium over the market price for their ordinary shares.

Our ordinary shares have only been publicly traded since August 6, 2009 and our share price has been volatile since then and may fluctuate substantially in the future.

Our ordinary shares were sold in our initial public offering, or IPO, in August 2009 at a price of \$15.00 per share, and have subsequently traded as high as \$19.94 per share and as low as \$14.33 per share through March 3, 2010. The trading price of our ordinary shares could be subject to wide fluctuations in response to many risk factors listed in this Risk Factors section, and others beyond our control, including:

actual or anticipated fluctuations in our financial condition and operating results;

overall conditions in the semiconductor market;

addition or loss of significant customers;

changes in laws or regulations applicable to our products;

Edgar Filing: Avago Technologies LTD - Form 10-Q

actual or anticipated changes in our growth rate relative to our competitors;

announcements of technological innovations by us or our competitors;

announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

additions or departures of key personnel;

competition from existing products or new products that may emerge;

issuance of new or updated research or reports by securities analysts;

fluctuations in the valuation of companies perceived by investors to be comparable to us;

disputes or other developments related to proprietary rights, including patents, litigation matters and our ability to obtain intellectual property protection for our technologies;

Table of Contents

announcement of, or expectation of additional financing efforts;

sales of our ordinary shares by us or our shareholders;

share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;
the expiration of contractual lock-up agreements with our executive officers, directors and greater than 5% shareholders; and

general economic and market conditions.

Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our ordinary shares. You may not realize any return on your investment in us and may lose some or all of your investment. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

There has been a public market for our ordinary shares for only a short period of time. An active, liquid and orderly market for our ordinary shares may not develop or be sustained, which could depress the trading price of our ordinary shares. An inactive market may also impair our ability to raise capital to continue to fund operations by selling shares and may impair our ability to acquire other companies or technologies by using our shares as consideration.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

The trading market for our ordinary shares depends, in part, on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

Future sales of our ordinary shares in the public market could cause our share price to fall.

Sales of a substantial number of our ordinary shares in the public market, or the perception that these sales might occur, could depress the market price of our ordinary shares and could impair our ability to raise capital through the sale of additional equity securities.

The holders of approximately 160.8 million ordinary shares have signed lock-up agreements with the underwriters of our secondary public offering, which occurred on January 27, 2010, under which they have agreed not to sell, transfer or dispose of, directly or indirectly, any shares of our ordinary shares or any securities convertible into or exercisable or exchangeable for ordinary shares without the prior written consent of the underwriters of the offering for a period of 90 days after the offering, subject to a possible extension under certain circumstances. Of the shares that are subject to lock-up agreements, approximately 159.3 million ordinary shares are subject to the contractual transfer restrictions in our Shareholder Agreement, which is described under "Certain Relationships and Related Party Transactions" Second Amended and Restated Shareholder Agreement "Transfer Restrictions" in the prospectus for our secondary public offering. An aggregate of approximately 1.9 million shares held by members of our board of directors and employees are subject to transfer restrictions, subject to certain exceptions pursuant to the terms of the management shareholders agreement, or Management Shareholders Agreement, to which they are party, or the terms of the equity incentive plan under which such shares were granted, as applicable. These transfer restrictions continue until the fifth anniversary of the date of purchase or, in the case of shares purchased upon exercise of options, the date of grant of the option. These shares are currently scheduled to be released from such transfer restrictions as follows: approximately 0.5 million shares in 2010, approximately 1.4 million shares in 2011, no shares in 2012 and less than 0.1 million shares in 2013. These remaining shares will generally become available for sale subject to compliance with applicable securities laws or upon expiration of these lock-up agreements or other contractual restrictions.

The underwriters may, in their sole discretion, release shares from the lock-up agreements entered into in connection with our secondary public offering. Similarly, the Company and the Sponsors may decide to waive the restrictions in the Shareholder Agreement or the Management Shareholders Agreements.

Table of Contents

Holders of approximately 161.1 million ordinary shares are entitled to rights with respect to registration of such shares under the Securities Act pursuant to a registration rights agreement. See "Certain Relationships and Related Party Transactions - Registration Rights Agreement" in the prospectus for our secondary public offering. In addition, upon exercise by our executive officers and certain other employees of outstanding options granted under our pre-IPO equity incentive plans, our executive officers and those other employees will be entitled to rights with respect to registration of the ordinary shares acquired on exercise. If such holders, by exercising their registration rights, sell a large number of shares, they could adversely affect the market price for our ordinary shares. If we file a registration statement for the purposes of selling additional shares to raise capital, and are required to include shares held by these holders pursuant to the exercise of their registration rights, our ability to raise capital may be impaired.

We also filed a registration statement on Form S-8 under Securities Act to register approximately 41 million shares for issuance under our equity incentive plans. These shares can be freely sold in the public market upon issuance and once vested, subject to lock-up restrictions in connection with our secondary public offering and other restrictions provided under the terms of the Management Shareholders Agreements, the applicable plan and/or the option agreements entered into with option holders.

The requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain qualified board members.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the Sarbanes-Oxley Act, listing requirements of the Nasdaq Global Select Market and other applicable securities rules and regulations. Compliance with these rules and regulations increases our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and increases demand on our systems and resources. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could have a material adverse effect on our business, financial condition and results of operations. We may need to hire more employees in the future, which will increase our costs and expenses. Furthermore, as we grow our business or acquire new businesses, our internal controls will become more complex and we may require significantly more resources to ensure our internal controls overall remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and our business may be harmed.

Being a public company makes it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on committees of our board of directors, and qualified executive officers.

Table of Contents

Singapore corporate law may impede a takeover of our company by a third-party, which could adversely affect the value of our ordinary shares.

The Singapore Code on Take-overs and Mergers contains provisions that may delay, deter or prevent a future takeover or change in control of our company for so long as we remain a public company with more than 50 shareholders and net tangible assets of S\$5 million (approximately US\$3.6 million) or more. Any person acquiring an interest, whether by a series of transactions over a period of time or not, either on their own or together with parties acting in concert with such person, in 30% or more of our voting shares, or, if such person holds, either on their own or together with parties acting in concert with such person, between 30% and 50% (both inclusive) of our voting shares, and such person (or parties acting in concert with such person) acquires additional voting shares representing more than 1% of our voting shares in any six-month period, must, except with the consent of the Securities Industry Council in Singapore, extend a mandatory takeover offer for the remaining voting shares in accordance with the provisions of the Singapore Code on Take-overs and Mergers. While the Singapore Code on Take-overs and Mergers seeks to ensure equality of treatment among shareholders, its provisions may discourage or prevent certain types of transactions involving an actual or threatened change of control of our company. These legal requirements may impede or delay a takeover of our company by a third-party, which could adversely affect the value of our ordinary shares.

Our actual operating results may differ significantly from our guidance.

From time to time, we release guidance regarding our future performance that represents our management's estimates as of the date of release. This guidance, which consists of forward-looking statements, is prepared by our management and is qualified by, and subject to, the assumptions and the other information contained or referred to in the release. Our guidance is not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our independent registered public accounting firm nor any other independent expert or outside party compiles or examines the guidance and, accordingly, no such person expresses any opinion or any other form of assurance with respect thereto.

Guidance is based upon a number of assumptions and estimates that, while presented with numerical specificity, is inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. We generally state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed but are not intended to represent that actual results could not fall outside of the suggested ranges. The principal reason that we release this data is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results will vary from the guidance and the variations may be material. Investors should also recognize that the reliability of any forecasted financial data diminishes the farther in the future that the data is forecast. In light of the foregoing, investors are urged to put the guidance in context and not to place undue reliance on it.

Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this Quarterly Report on Form 10-Q could result in the actual operating results being different than the guidance, and such differences may be adverse and material.

Table of Contents

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

Unregistered Sales of Equity Securities

None.

Use of Proceeds

None.

Repurchases

None.

Item 3. Defaults Upon Senior Securities

None.

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

No matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the first quarter of the fiscal year covered by this report.

Item 5. Other Information

On March 3, 2010, the Company, Bali Investments S.à.r.l and Mr. Douglas R. Bettinger, our Senior Vice President and Chief Financial Officer, in his capacity as Trustee of the Bettinger Family Revocable Trust, dated June 6, 2007, entered into a Limited Release under Management Shareholders Agreement. Under this agreement, 7,390 ordinary shares of the Company held by the Bettinger Family Revocable Trust, dated June 6, 2007, were released from all provisions of the Management Shareholders Agreement, dated as of August 4, 2008, or the MSA, among the Company, Bali Investments S.à.r.l and Mr. Bettinger. The MSA, among other matters, restricts the transfer, sale, assignment, or disposition of ordinary shares of the Company held by Mr. Bettinger or his permitted transferees.

Table of Contents

Item 6. Exhibits

Exhibit Number	Description	Incorporated by Reference Herein Form	Filing Date	Filed Herewith
3.1	Memorandum and Articles of Association	Avago Technologies Limited Current Report on Form 8-K (Commission File No. 001-34428)	August 14, 2009	
4.1	Second Amended and Restated Shareholder Agreement, dated August 11, 2009, among Avago Technologies Limited, Silver Lake Partners II Cayman, L.P., Silver Lake Technology Investors II Cayman, L.P., Integral Capital Partners VII, L.P., KKR Millennium Fund (Overseas), Limited Partnership, KKR European Fund, Limited Partnership, KKR European Fund II, Limited Partnership, KKR Partners (International), Limited Partnership, Capstone Equity Investors LLC, Avago Investment Partners, Limited Partnership, Bali Investments S.à.r.l., Seletar Investments Pte Ltd, Geyser Investment Pte. Ltd. and certain other Persons	Avago Technologies Limited Current Report on Form 8-K (Commission File No. 001-34428)	August 14, 2009	
10.1	Termination and Agreement, dated January 21, 2010, among Avago Technologies Limited, Bali Investments S.à.r.l and Dick M. Chang	Avago Technologies Limited Registration Statement on Form S-1 (Commission File No. 333-164368)	January 25, 2010	
10.2	Limited Release Under Management Shareholders Agreement, dated March 3, 2010, among Avago Technologies Limited, Douglas R. Bettinger as Trustee for the Bettinger Family Trust, dated June 6, 2007, and Bali Investments S.à.r.l			X
31.1	Certification of Principal Executive Officer Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			X
31.2	Certification of Principal Financial Officer Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			X
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			X
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			X

Table of Contents

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.

AVAGO TECHNOLOGIES LIMITED

By: /s/ DOUGLAS R. BETTINGER
 Douglas R. Bettinger

Senior Vice President and Chief Financial Officer

Date: March 4, 2010