

MINDSPEED TECHNOLOGIES, INC

Form 10-Q

August 05, 2008

[Table of Contents](#)

**UNITED STATES SECURITIES AND EXCHANGE  
COMMISSION**

Washington, D.C. 20549



# FORM 10-Q

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

**For the quarterly period ended June 27, 2008**

**OR**

**OR**

o

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

**Commission file number: 000-50499**

**MINDSPEED TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of incorporation)

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

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

**92660-3095**  
(Zip code)

Registrant's telephone number, including area code:

**(949) 579-3000**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

The number of outstanding shares of the Registrant's Common Stock as of July 25, 2008 was 23,813,151.



Table of Contents

**FORWARD-LOOKING STATEMENTS**

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

- the ability of our relationships with network infrastructure original equipment manufacturers to facilitate early adoption of our products, enhance our ability to obtain design wins and encourage adoption of our technology in the industry;
- the growth prospects for the network infrastructure equipment and communications semiconductors markets, including increased demand for network capacity, the upgrade and expansion of legacy networks, and the build-out of networks in developing countries;
- our plans to make substantial investments in research and development and participate in the formulation of industry standards;
- our ability to achieve design wins and convert wins into revenue;
- the continuation of intense price and product competition, and the resulting declining average selling prices for our products;
- the value of our intellectual property and our strategy regarding sales and licensing of non-core intellectual property;
- the impact of changes in customer purchasing activities, inventory levels and inventory management practices;



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- the importance of attracting and retaining highly skilled, dedicated personnel;
- the challenges of shifting any operations or labor offshore, including the likelihood of competition in offshore markets for qualified personnel;
- our ability to achieve revenue growth and profitability, or to sustain positive cash flows from operations, and the expected period through which we will continue to incur losses;
- our plans to reduce operating expenses, the amount and timing of any such expense reductions, and its effects on cash flow;
- our anticipation that we will not pay a dividend in the foreseeable future;
- the dependence of our operating results on our ability to develop and introduce new products and enhancements to existing products on a timely basis;
- the continuation of a trend toward industry consolidation and the effect it could have on our operating results;
- our belief that we are benefiting from the increased deployment of internet protocol-based networks both in new network buildouts worldwide and the replacement of circuit-switched networks;
- the sufficiency of our existing sources of liquidity and expected sources of cash to fund our operations, research and development efforts, anticipated capital expenditures, working capital and other financing requirements for the next 12 months;
- the circumstances under which we may need to seek additional financing, our ability to obtain any such financing and any consideration of acquisition opportunities;
- our expectation that our provision for income taxes for fiscal 2008 will principally consist of income taxes related to our foreign operations;

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

Table of Contents

- our restructuring plans, including expected workforce reductions and facilities closures, the expected cost savings under our restructuring plans and the uses of those savings, the timing and amount of payments to complete the actions, the source of funds for such payments, the impact on our liquidity and the resulting decreases in our research and development and selling, general and administrative expenses, and the amounts of future charges to complete our restructuring plans;
- our beliefs regarding the effect of the disposition of pending or asserted legal matters;
- our acquisition strategy, the means of financing such a strategy, and the impact of any past or future acquisitions, including the impact on revenue, margin and profitability;
- our intentions to market, sell and support acquired Ethernet aggregation products and to develop and further extend the Ethernet MAC product line;
- our plans relating to our use of stock-based compensation, the effectiveness of our incentive compensation programs and the expected amounts of stock-based compensation expense in future periods;
- our belief that the financial stability of suppliers is an important consideration in our customers' purchasing decisions;
- the amount and timing of future payments under contractual obligations; and
- the impact of recent accounting pronouncements and the adoption of new accounting standards.

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

- future operating losses;

- cash requirements and terms and availability of financing;
- worldwide political and economic uncertainties and specific conditions in the markets we address;
- loss of or diminished demand from one or more key customers or distributors;
- fluctuations in the price of our common stock and our operating results;
- our ability to attract and retain qualified personnel;
- constraints in the supply of wafers and other product components from our third-party manufacturers;
- doing business internationally;
- pricing pressures and other competitive factors;
- successful development and introduction of new products;
- our ability to successfully and cost effectively establish and manage operations in foreign jurisdictions;
- industry consolidation;
- order and shipment uncertainty;
- our ability to obtain design wins and develop revenues from them;

- lengthy sales cycles;
- the expense of and our ability to defend our intellectual property against infringement claims by others;
- product defects and bugs; and
- business acquisitions and investments.

Table of Contents

The forward-looking statements in this report are subject to additional risks and uncertainties, including those set forth in Part II, Item 1A under the heading "Risk Factors" and those detailed from time to time in our other filings with the SEC. These forward-looking statements are made only as of the date hereof and, except as required by law, we undertake no obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

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Table of Contents

MINDSPEED TECHNOLOGIES, INC.

INDEX

	PAGE
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	<u>Financial Statements (unaudited):</u>
	<u>Consolidated Condensed Balance Sheets June 27, 2008 and September 28, 2007</u> 6
	<u>Consolidated Condensed Statements of Operations Three Months and Nine Months Ended June 27, 2008 and June 29, 2007</u> 7
	<u>Consolidated Condensed Statements of Cash Flows Three Months and Nine Months Ended June 27, 2008 and June 29, 2007</u> 8
	<u>Notes to Consolidated Condensed Financial Statements</u> 9
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 17
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 27
<u>Item 4.</u>	<u>Controls and Procedures</u> 28
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1A.</u>	<u>Risk Factors</u> 29
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u> 40
<u>Item 6.</u>	<u>Exhibits</u> 41
	<u>Signature</u> 43

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MINDSPEED TECHNOLOGIES, INC.****Consolidated Condensed Balance Sheets****(unaudited, in thousands, except per share amounts)**

	June 27, 2008	September 28, 2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 29,898	\$ 25,796
Receivables, net of allowance for doubtful accounts of \$348 and \$353 at June 27, 2008 and September 28, 2007, respectively	17,155	13,584
Inventories	10,551	15,023
Other current assets	2,375	3,763
Total current assets	59,979	58,166
Property, plant and equipment, net	13,314	13,147
Intangible assets, net	2,635	3,200
Goodwill	2,429	2,324
License agreements, net	3,239	1,798
Other assets	2,763	3,444
Total assets	\$ 84,359	\$ 82,079
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 8,521	\$ 7,117
Deferred income on sales to distributors	3,739	4,226
Accrued compensation and benefits	6,950	5,286
Accrued income tax	92	752
Restructuring	163	1,478
Other current liabilities	2,839	3,493
Total current liabilities	22,304	22,352
Convertible senior notes	45,365	45,037
Other liabilities	598	444
Total liabilities	68,267	67,833
Commitments and contingencies (Note 4)		
<b>Stockholders Equity</b>		
Preferred stock, \$0.01 par value: 25,000 shares authorized; no shares issued or outstanding		(7) FMR Corp. is a parent holding company. Fidelity Management & Research Company ( Fidelity ), which is a wholly-owned subsidiary of FMR



Corp. and is a registered investment advisor, beneficially owns 4,875,718 shares of Class A Common Stock. Mr. Johnson, FMR Corp. (through its control of Fidelity) and the Fidelity funds state that each has sole power to dispose of those 4,875,718 shares; however, none of them has sole power to vote or direct the voting of the shares, which power resides with the Boards of Trustees of the funds. Fidelity Management Trust Company, another wholly-owned subsidiary of FMR Corp., beneficially owns 256,115 shares of Class A Common Stock. Mr. Johnson and FMR Corp. (through its control of Fidelity Management Trust Company) state that each has sole dispositive and voting power over those 256,115 shares. Fidelity International Limited ( FIL ), a former wholly-owned subsidiary of FMR Corp. whose shares previously were distributed to the shareholders of FMR Corp., beneficially owns 733,900 shares of Class A Common Stock, over which FIL has sole dispositive and voting power.

- (8) Includes 58,932 restricted Class B shares, and 126,776 Class B shares that may be acquired by Dr. Bertolucci pursuant to exercisable stock options. (See Compensation Committee Report on Executive Compensation Long Term Incentives below for a discussion of the restrictions on restricted stock.) Also includes 15,820 Class B shares held by Dr. Bertolucci pursuant to the Company's 401(k) plan.
- (9) Includes 4,500 restricted Class B shares, and 4,000 Class B shares that may be acquired by Mr. Callaway pursuant to exercisable stock options.
- (10) Includes 65,267 restricted Class B shares, and 74,000 Class B shares that may be acquired by Mr. Coombs pursuant to exercisable stock options.
- (11) Includes 4,500 restricted Class B shares, and 53,000 Class B shares that may be acquired by Ms. Dillon-Ridgley pursuant to exercisable stock options.
- (12) Includes 140 Class A shares held by Mr. Gable as custodian for his son. Includes 4,500 restricted Class B shares, and includes 13,000 Class B shares that may be acquired by Mr. Gable pursuant to exercisable stock options.
- (13) Includes 456,713 restricted Class B shares, and 394,470 Class B shares that may be acquired by Mr. Hendrix pursuant to exercisable stock options. Also includes 4,595 Class B shares beneficially owned by Mr. Hendrix pursuant to the Company's 401(k) plan.
- (14) Includes 4,500 restricted Class B shares, and 13,000 Class B shares that may be acquired by Dr. Henton pursuant to exercisable stock options.
- (15) Includes 4,500 restricted Class B shares, and 19,000 Class B shares that may be acquired by Mr. Kennedy pursuant to exercisable stock options. Mr. Kennedy serves on the Board of Trustees of Ariel Mutual Funds, for which Ariel Capital Management, Inc. serves as investment advisor and performs services which include buying and selling securities on behalf of the Ariel Mutual Funds. Mr. Kennedy disclaims beneficial ownership of all Class A shares held by Ariel Capital Management, Inc. as investment advisor for Ariel Mutual Funds.
- (16) Includes 400 Class A shares and 157,004 Class B shares held by Mr. Lanier's wife. Also includes 4,500 restricted Class B shares, and 13,000 Class B shares that may be acquired by Mr. Lanier pursuant to exercisable stock options. Mr. Lanier disclaims beneficial ownership of the shares owned by his wife.
- (17) Includes 4,500 restricted Class B shares, and 19,000 Class B shares that may be acquired by Mr. Miller pursuant to exercisable stock options.
- (18) Includes 4,500 restricted Class B shares, and 53,000 Class B shares that may be acquired by Mr. Oliver pursuant to exercisable stock options.
- (19) Includes 4,500 restricted Class B shares, and 3,000 Class B shares that may be acquired by Mr. van Andel pursuant to exercisable stock options.
- (20) Includes 237,087 restricted Class B shares, and 256,115 Class B shares that may be acquired by Mr. Wells pursuant to exercisable stock options. Also includes 8,746 Class B shares beneficially owned by Mr. Wells pursuant to the Company's 401(k) plan.
- (21) Includes 159,351 restricted Class B shares, and 150,595 Class B shares that may be acquired by Mr. Willoch pursuant to exercisable stock options.
- (22) Includes 1,276,283 restricted Class B shares, and 1,457,956 Class B shares that may be acquired by all executive officers and directors as a group pursuant to exercisable stock options. Also includes 58,407 Class B shares that are beneficially owned pursuant to the Company's 401(k) plan.

### EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information concerning the Company's equity compensation plans as of January 2, 2005.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)

#### Equity Compensation Plans Approved by Security Holders:

Interface, Inc. Omnibus Stock Incentive Plan(1)	3,174,571	\$5.57	1,175,500(2)
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Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Interface, Inc. Key Employee Stock Option Plan (1993)	212,000	\$7.70	0
<b>Total</b>	3,386,571	\$5.71	1,175,500
<b>Equity Compensation Plans Not Approved by Security Holders:</b>			
Offshore Stock Option Plan	46,000	\$7.42	0
Individual Compensation Arrangements (3)	82,572	\$5.92	0
<b>Total</b>	128,572	\$6.46	0

- (1) The Interface, Inc. Omnibus Stock Incentive Plan (the Omnibus Plan), which was originally approved by shareholders in 1997, is the only currently-outstanding equity compensation plan pursuant to which awards may be made. The Interface, Inc. Key Employee Stock Option Plan (1993) (the Key Employee Plan) and the Offshore Stock Option Plan (the Offshore Plan) were terminated, as to new grants, as of the effective date of the Omnibus Plan. Grants under the Key Employee Plan and Offshore Plan that were outstanding upon termination of those plans, however, remained outstanding.
- (2) The number of securities remaining available for future issuance under the Omnibus Plan (excluding securities reflected in column (a)) as of January 2, 2005 was 1,175,500. Shares outstanding under the Key Employee Plan and Offshore Plan that are forfeited, terminated or otherwise expire unexercised after January 2, 2005 would also become available for issuance under the Omnibus Plan.
- (3) As of January 2, 2005, the Company maintained stock option agreements outside the other listed equity plans with four non-employee individuals (such as consultants, advisors or suppliers) with respect to a total of 82,572 shares (comprised of 24,000 options at \$7.00 per share, 28,572 options at \$6.19 per share, 20,000 options at \$4.8125 per share, and 10,000 options at \$4.8125 per share, respectively). These agreements typically provide for a five-year vesting period (all options under these agreements have now vested) and a ten-year term.

## EXECUTIVE COMPENSATION AND RELATED ITEMS

### Summary of Cash and Certain Other Compensation

The following table sets forth, for each of the last three fiscal years of the Company, certain information concerning compensation paid by the Company and its subsidiaries to the Company's Chief Executive Officer and to each of the four other most highly compensated executive officers of the Company (referred to herein as the named executive officers) based on salary and bonus earned in fiscal 2004. For each of the last three fiscal years of the Company, the total amount of perquisites and other personal benefits paid to each named executive officer did not exceed the lesser of \$50,000 or 10% of such officer's total annual salary and bonus, and thus are not included in the table.

### Summary Compensation Table

Name and Principal Position	Annual Compensation			Long Term Compensation Awards		
	Year	Salary (\$)	Bonus (\$)	Restricted Stock Awards (\$ (1))	Securities Underlying Options (#)	All Other Compensation (\$ (2))
Daniel T. Hendrix	2004	650,062	593,450	292,500	50,000	90,610

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	Annual Compensation			Long Term Compensation Awards		
President and Chief	2003	637,520	155,384	135,500	50,000	76,032
Executive Officer	2002	500,000	47,250	280,000	50,000	76,032
John R. Wells	2004	400,000	326,308	175,500	30,000	11,649
Senior Vice President	2003	396,666	153,039	81,300	30,000	9,056
(Division President)	2002	360,000	0	112,000	20,000	7,200
Robert A. Coombs <sup>(3)</sup>	2004	300,916	251,453	58,500	10,000	27,082
Vice President	2003	285,820	241,161	40,650	15,000	25,724
(Division President)	2002	214,189	102,696	140,000	0	85,570
Raymond S. Willoch	2004	305,000	231,404	117,000	20,000	8,186
Senior Vice President	2003	303,333	58,328	54,200	20,000	7,037
and General Counsel	2002	285,000	28,728	112,000	0	5,833
Michael D. Bertolucci	2004	288,750	219,075	0	0	7,968
Senior Vice President	2003	274,999	52,940	0	0	6,745
	2002	274,999	27,719	0	20,000	5,868

- (1) Represents the dollar value of restricted stock awarded to the named executive officer (calculated by multiplying the number of shares awarded by the closing price of the Company's Class A Common Stock as reported by the Nasdaq Stock Market on the date of grant). As of January 2, 2005, total restricted stock awards outstanding and related fair market values (based on the closing price of the Company's Class A Common Stock as reported by the Nasdaq Stock Market on December 31, 2004) were as follows: Mr. Hendrix 391,713 shares (\$3,905,379); Mr. Wells 197,087 shares (\$1,964,957); Mr. Coombs 37,167 shares (\$370,555); Mr. Willoch 128,851 shares (\$1,284,644); and Mr. Bertolucci 58,932 shares (\$587,552). Awards of restricted stock vest in increments of one-third, except for the 2004 awards which vest in increments of one-half. With respect to each award made prior to 2003, the first two increments (one-third each) vest no earlier than the second and fourth anniversaries, respectively, of the grant date of the award and only if the price of the Company's Class A Common Stock on or after such anniversary has appreciated to a specified target level (such target level is equal to 15% appreciation per annum, compounded annually, through the applicable anniversary date), and the final one-third increment vests upon the ninth anniversary of the grant date (except that, for the 2002 awards, the final one-third vests upon the seventh anniversary of the grant date). With respect to the 2003 awards, the first two increments (one-third each) vest no earlier than the first and third anniversaries, respectively, of the grant date and only if a pre-determined performance target has been met on or after such anniversary (for Messrs. Hendrix and Willoch, the performance target is based on appreciation of Class A Common Stock price and, for Messrs. Wells and Coombs, the performance target is based on increases in sales volumes within their respective business units). The final one-third of the 2003 awards vests upon the seventh anniversary of the grant date. The 2004 awards vest in two increments (one-half each) no earlier than the second

10

and third anniversaries, respectively, of the grant date and only if a pre-determined performance target has been met on or after such anniversary (the performance targets for the 2004 awards are based on the same criteria as the 2003 awards). All unvested awards (i.e., all award shares not vested previously under the performance criteria) will vest on the ninth anniversary of the grant date for awards made prior to 2002, on the seventh anniversary of the grant date for the 2002 and 2003 awards, and on the fifth anniversary of the grant date for the 2004 awards. Shares of restricted stock have voting rights, and dividends (to the extent any are declared by the Board of Directors) are paid on those shares.

- (2) Includes the Company's matching contribution under the Company's 401(k) plan and/or its Nonqualified Savings Plan (\$18,578, \$11,649, \$8,186 and \$7,968 for Messrs. Hendrix, Wells, Willoch and Bertolucci, respectively, in 2004), and, in the case of Mr. Hendrix, the dollar value of the annual premiums paid by the Company under a life insurance policy pursuant to a split-dollar insurance agreement with him (\$72,032 in 2004). For Mr. Coombs, includes the employer's contribution under a pension plan (\$27,082 in 2004).
- (3) Mr. Coombs was compensated in currencies other than the U.S. dollar. All compensation amounts for Mr. Coombs have been translated into U.S. dollars at the exchange rate in effect at the end of the respective fiscal year.

**Compensation Pursuant to Salary Continuation Plan**

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The Company maintains a nonqualified salary continuation plan (the Salary Continuation Plan) which is designed to induce selected employees of the Company to remain in the employ of the Company by providing them with retirement, disability and death benefits in addition to those which they may receive under the Company's other benefit programs. The Salary Continuation Plan entitles participants to (i) retirement benefits upon normal retirement from the Company at age 65 (or early retirement as early as age 55) after completing at least 15 years of service with the Company (unless otherwise provided in the plan), payable for the remainder of their lives (or, if elected by a participant, a reduced benefit is payable for the remainder of the participant's life and any surviving spouse's life) and in no event for less than 10 years under the death benefit feature; (ii) disability benefits payable for the period of any pre-retirement total disability; and (iii) death benefits payable to the designated beneficiary of the participant for a period of up to 10 years (or, if elected by a surviving spouse that is the designated beneficiary, a reduced benefit is payable for the remainder of such surviving spouse's life). Benefits are determined according to one of three formulas contained in the Salary Continuation Plan. The Salary Continuation Plan is administered by the Compensation Committee, which has full discretion in choosing participants and the benefit formula applicable to each. The Company's obligations under the Salary Continuation Plan are currently unfunded (although the Company has used insurance instruments to hedge its exposure thereunder); however, the Company is required to contribute the present value of its obligations thereunder to an irrevocable grantor trust in the event of a Change in Control (as such term is defined in the Salary Continuation Plan) of the Company. Each of Messrs. Hendrix, Wells and Willoch has entered into a Salary Continuation Agreement with the Company pursuant to the Salary Continuation Plan.

### Stock Option Grants

The following table sets forth information with respect to options granted to the named executive officers during fiscal 2004.

#### Option Grants in Last Fiscal Year

##### Individual Grants

Name	Number of Securities Underlying Options Granted(1)	Percent of Total Options Granted to Employees in 2004	Exercise Price (per share)(1)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (2)	
					5%	10%
Daniel T. Hendrix	50,000	9.1%	\$5.53	01/02/09	\$76,392	\$168,806
John R. Wells	30,000	5.5%	5.53	01/02/09	45,835	101,284
Robert A. Coombs	10,000	1.8%	5.53	01/02/09	15,278	33,761
Raymond S. Willoch	20,000	3.7%	5.53	01/02/09	30,557	67,522
Michael D. Bertolucci	0	N/A	N/A	N/A	N/A	N/A

11

- (1) All options were granted at an exercise price equal to the fair market value of the Class A Common Stock on the date of grant. These options vested 50% at the time of the grant and 50% on December 31, 2004, and have a term of five years.
- (2) These amounts represent certain assumed rates of appreciation only, from the original exercise price on the date of grant to the end of the option term. Actual gains, if any, on stock option exercises are dependent on the future performance of the Class A Common Stock and overall market conditions. The amounts reflected in this table may not necessarily be indicative of actual results.

### Option Exercises and Year-End Option Values

The following table sets forth, for each of the named executive officers, (i) the number of shares of Common Stock received upon exercise of options, (ii) the aggregate dollar value received upon exercise, (iii) the number of options held at fiscal year-end, and (iv) the value of such options at fiscal year-end.

#### Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

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Name	Shares Acquired On Exercise (#)	Value Realized (\$)	Number of Unexercised Options at Fiscal Year-End (#) Exercisable/Unexercisable	Value of Unexercised In-the-Money Options At Fiscal Year-End (\$)(1) Exercisable/Unexercisable
Daniel T. Hendrix	0	0	367,936/92,068	\$1,325,283/\$266,676
John R. Wells	25,500	\$ 171,406	261,897/30,437	\$998,111/\$101,761
Robert A. Coombs	42,000	\$ 254,850	71,000/33,000	\$172,575/\$139,573
Raymond S. Willoch	25,000	\$ 117,395	136,855/26,480	\$347,598/\$102,559
Michael D. Bertolucci	26,300	\$ 73,574	115,336/21,822	\$246,224/\$88,692

(1) Aggregate market value of the shares issuable upon exercise of the options (based on December 31, 2004 closing price for Class A Common Stock of \$9.97 per share), less the aggregate exercise price payable by the named executive officer.

### Employment Agreements

In April 1997, the Company entered into substantially similar employment agreements with each of Messrs. Hendrix, Wells, Willoch and Bertolucci. Each of their agreements is for a rolling two-year term, such that the remaining term is always two years (until such time as the executive reaches the age of 63, at which time the term is fixed for an additional two years and then expires upon the executive reaching age 65). The Company may terminate any of such agreements upon two years' notice. In the event that the Company terminates an officer's employment without just cause, the officer will be entitled to continue to receive his salary and bonus, and participate in certain employee benefit plans, for the remainder of the term of the agreement. The officer also will immediately vest in all unvested employee stock options, and a percentage of theretofore unvested restricted stock awards (as specified in the applicable restricted stock agreement). The employment agreements also contain provisions placing restrictions on the officer's ability to compete with the Company following the termination of the agreement.

### Change in Control Agreements

In April 1997, each of Messrs. Hendrix, Wells, Willoch and Bertolucci entered into substantially similar change in control agreements with the Company. Each of their agreements is for a rolling two-year term, such that the remaining term is always two years (until such time as the executive reaches the age of 63, at which time the term is fixed for an additional two years and then expires upon the executive reaching age 65). The Company generally may terminate any of such agreements upon two years' notice. The agreements provide for certain benefits in the event of a termination of employment under certain circumstances in connection with a Change in Control (as defined in the agreements) of the Company. In general, each agreement provides benefits to the officer upon an Involuntary Termination (essentially, termination without cause) or a Voluntary Termination (essentially, resignation in the face of coercive tactics) occurring within 24 months after or six months prior to the date of a change in control. Upon any such termination, the officer will be entitled to receive the following benefits: (i) the officer's then-current salary, for the balance of the term, paid in a lump sum discounted to present value; (ii) bonus payments for the balance of the term, paid in a lump sum discounted to present value and based upon the bonuses received during the two years prior to the termination, as well as a prorated bonus for the year in which employment

12

is terminated; (iii) continuation of health and life insurance coverage for the balance of the term; and (iv) continuation of eligibility to participate in Company retirement plans for the balance of the term, or the provision of comparable benefits. In addition, the officer will immediately vest in all unvested employee stock options and restricted stock awards in the event of a Change in Control. Benefits paid under the change in control agreements will be reduced by the compensation and benefits, if any, paid to an officer pursuant to his employment agreement with the Company. If the payment of any such benefits would result in the imposition of an excise tax under Section 4999 of the Internal Revenue Code, the officer is entitled to receive a gross-up payment to cover the amount of the excise taxes and any related taxes on the gross-up payment.

### Compensation of Directors

The Company's non-employee directors (outside directors) are paid an annual director's fee of \$30,000, plus \$1,000 for each Board or Board committee meeting attended. Outside directors who serve on the Audit Committee or the Compensation Committee are paid an additional \$5,000 per year, except that the Chairperson of the Audit Committee and the Chairperson of the Compensation Committee are paid an additional

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\$10,000 per year (rather than \$5,000). Directors also are reimbursed for expenses in connection with attending Board and committee meetings.

In 2004, each director also was awarded 3,000 restricted shares of Company stock. The awards of restricted stock vest in two increments of one-half each, no earlier than the first and second anniversaries, respectively, of the grant date of the award and only if the price of the Company's Class A Common Stock on or after such anniversary has appreciated to a specified target level (such target level is equal to 15% appreciation per annum, compounded annually, through the applicable anniversary date). All unvested shares will vest on the third anniversary of the grant date.

### **Certain Relationships and Related Transactions**

Ray C. Anderson, who serves as Chairman of the Board and Chairman of the Executive Committee of the Board, remains an employee of the Company. In his capacity as an employee, Mr. Anderson was compensated during 2004 as follows: (i) salary and bonus of \$1,040,000, (ii) annual premiums of \$173,000 paid by the Company under certain life insurance policies pursuant to a split-dollar insurance agreement between the Company and Mr. Anderson; and (iii) miscellaneous perquisites of \$60,498. In addition, as an employee of the Company, Mr. Anderson also was covered by certain of the Company's benefits programs, such as medical and dental insurance plans. Mr. Anderson received no awards of restricted stock or stock options during 2004. Mr. Anderson entered into an employment agreement and a change in control agreement with the Company in April 1997, each of which is substantially similar to those described above for Messrs. Hendrix, Wells, Willoch and Bertolucci (except that the term of each of Mr. Anderson's agreements is a rolling two-year term until such time as he reaches the age of 70, at which time the term is fixed for an additional two years and then expires upon his reaching age 72). Mr. Anderson also has entered into a salary continuation agreement with the Company pursuant to the Salary Continuation Plan described above. In connection with Mr. Anderson's transition from Chief Executive Officer to non-executive Chairman in 2001, his future retirement benefit under the salary continuation agreement was set at \$486,060 per year.

Prior to 2003, the Company made loans to Mr. Anderson, primarily in connection with Mr. Anderson's payment of income taxes that were due prior to the payment of expected compensation from the Company. The largest aggregate amount of such indebtedness outstanding at any time during fiscal 2004 was \$573,718. The indebtedness now bears interest at the Company's marginal cost of funds, which currently is equal to the 6-month LIBOR plus 200 basis points. The indebtedness is due by no later than February 28, 2006, with mandatory prepayments from any bonuses (less withholding amounts required by law) received by Mr. Anderson prior to that time. The amount outstanding as of March 1, 2005 was \$161,363.

A wholly-owned subsidiary of the Company employs James A. Lanier, Jr., son-in-law of Ray C. Anderson, as its Director of Sales for Colleges & Universities. In 2004, Mr. Lanier earned salary and bonus of \$211,844 and participated in certain of the Company's benefit programs generally available to employees in the U.S.

13

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## **COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION**

### **Overall Philosophy and Administration**

The goals of the Company's executive compensation program, as developed and administered by the Compensation Committee of the Board of Directors, include:

- Offering market competitive total compensation opportunities to attract and retain talented executives;
- Establishing strong links between the Company's performance and total compensation earned i.e., paying for performance ;
- Providing incentives for executives to achieve specific performance objectives;
- Promoting and facilitating executive officer stock ownership, and thereby motivate executives to think and act as owners; and
- Emphasizing the Company's mid and long term performance, thus enhancing shareholder value.

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The Committee intends that the Company's pay program provide compensation commensurate with the level of financial performance achieved, the responsibilities undertaken by the executives, and the compensation packages offered by comparable companies. The program currently consists of three principal components: (1) competitive base salaries; (2) annual cash bonuses based on the achievement of established performance goals; and (3) long term incentives such as awards of restricted stock and stock options. The Committee strives for each of these three components to receive substantial weighting each year so that a large portion of executive compensation is directly linked to advancing the Company's financial performance and the interests of shareholders. In addition, the Committee on occasion provides special incentive opportunities to executives for the accomplishment of specific performance objectives.

The Committee, which is composed entirely of independent directors, establishes base salaries for the executive officers, including the named executive officers. The Committee also administers the annual bonus program, the long term incentive program, and, when applicable, special incentive programs. In fulfilling its responsibilities, the Committee regularly seeks input from nationally-recognized, independent compensation consultants and periodically seeks input from appropriate Company executives.

### **Base Salaries**

The Committee generally strives to set base salaries at the market median (50<sup>th</sup> percentile) of salaries offered by other employers in our industry and other publicly traded companies with characteristics similar to the Company (size, growth rate, etc.), based on information provided by independent compensation consultants. Some of the companies considered from time to time are included in the list of companies comprising the self-determined peer group index used in the performance graph below.

In addition, the Committee may consider other factors when setting individual salary levels, which may result in salaries above or below the targeted amount. These factors include the executive's level of responsibility, achievement of goals and objectives, tenure with the Company, and specific background or experience, as well as external factors such as the availability of talent, the recruiting requirements of the particular situation, internal equalization policies of the Company, and general economic conditions.

Base salary adjustments for executive officers generally are made (if at all) annually and are dependent on the factors described above. Based on the foregoing considerations, the Committee approved a 2004 base salary increase of 5% for one named executive officer (Dr. Bertolucci), who had not received a raise in nearly three years. None of the other named executive officers received a base salary increase during 2004.

### **Annual Bonuses**

The Committee administers the shareholder-approved Executive Bonus Plan, which provides annual bonus opportunities for Company executives. Annual bonus opportunities provide an incentive for executives to earn compensation based on the achievement of important corporate or business unit (division or subsidiary) financial performance and individual performance goals. In determining the appropriate bonus opportunities, the Committee

14

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seeks to establish potential awards that, when combined with annual salary, place the total overall cash compensation for the Company's executives in the third quartile (between the market 50<sup>th</sup> percentile and the market 75<sup>th</sup> percentile) for comparable companies, provided that the performance objectives are substantially achieved.

Each executive officer of the Company, including the Chief Executive Officer, is assigned a bonus potential (typically ranging between 70% - 110% of base salary), and a personalized set of financial and, in the case of certain staff positions, non-financial objectives. Notably, in connection with the Company's cost reduction initiatives, each of the executive officers voluntarily reduced his bonus potential by an average of 10% for the year 2004 (and subsequent years). Actual awards can range from 0% to 125% of the bonus potential, depending on the degree to which the established objectives are achieved. In 2004, 100% of the bonus potential for the Chief Executive Officer and each of the executive officers who were directly accountable for the profitability of a business unit was based on measurable financial objectives, which consisted of growth in operating income, cash flow, revenue and earnings per share. Relative weights assigned to these financial objectives were 40%, 30%, 20% and 10%, respectively. (When the Board of Directors made the decision to exit the owned Re:Source dealer businesses, the Committee, in accordance with the bonus formulas it approved at the beginning of 2004, apportioned the financial objectives to account for the discontinued nature of those operations.) For executives who were not directly accountable for the profitability of a business unit, 80% of their bonus potential was based on these same financial objectives (relative weights assigned to the financial objectives were 30%, 25%, 15% and 10%, respectively), with the remaining 20% based on non-financial objectives. Evaluation of non-financial objectives is, inherently, somewhat subjective, and equal weight typically is assigned to each of these objectives.



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For 2004, each of the named executive officers received a bonus, which appears in the Summary Compensation Table of this Proxy Statement, as their respective performance objectives were determined to have been achieved, in part, for the year. The achievements included:

Americas floorcoverings (managed by Mr. Wells) experienced 32% growth in operating income and 19% growth in revenue in 2004;

Asia-Pacific floorcoverings (managed by Mr. Coombs) experienced 34% growth in operating income and 50% growth in revenue in 2004;

On a consolidated basis (applicable to Messrs. Hendrix, Willoch and Bertolucci), the Company experienced 94% growth in operating income and 15% growth in revenue in 2004; and

The Company's income per basic share from continuing operations (applicable to all of the named executive officers) was \$0.13 in 2004, compared with a loss per basic share from continuing operations of \$0.16 in 2003.

### Long Term Incentives

The Committee administers the shareholder-approved Interface, Inc. Omnibus Stock Incentive Plan, which is an equity-based plan that allows for long term incentive awards such as restricted stock and stock options. The long term incentive awards made during 2004 to Company executives consisted of the following:

Restricted stock grants with performance-based vesting acceleration features; and

Stock option grants, vesting in two equal installments (50% on the grant date and 50% on December 31, 2004).

Long term incentives are intended to attract and retain outstanding executive talent, create a direct link between shareholder and executive interests by focusing executive attention on increasing shareholder value, and motivate executives to achieve specific performance objectives. For instance, the stock options granted have an exercise price equal to at least 100% of the market price of the underlying Common Stock on the date of grant. Thus, the stock options only have value if the market price of the Company's stock rises after the grant date. Additionally, restricted stock awards generally vest over a period of multiple years (five years for the 2004 awards), giving the executive an incentive to remain employed with the Company for a significant time period to completely vest in an award. However, awards of restricted stock may vest earlier if specific performance criteria are met. For the executive officers directly accountable for the profitability of a business unit, the accelerated vesting criteria for the 2004 awards is based on improvement in the applicable business unit's performance, such as an increase in sales or operating income. For the Chief Executive Officer, and each of the staff executives not directly accountable for the profitability of a business unit, the accelerated vesting criteria for the 2004 awards is based on compounded annual growth of the Company's stock price.

15

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The size of the awards made to individual officers is based on an evaluation of several factors, including the officer's level of responsibility and the Company's overall compensation objectives. The amount and nature of prior equity incentive awards are generally considered in determining new Omnibus Stock Incentive Plan awards for executive officers. Consistent with prevailing practices in the marketplace, the Committee currently intends to make long term incentive awards to executives each fiscal year.

Please see the Summary Compensation Table and the Option Grants in Last Fiscal Year table of this Proxy Statement for the Omnibus Stock Incentive Plan awards made to the named executive officers in 2004.

### Special Incentives

From time to time, the Committee may implement special incentive programs which provide executives an opportunity to earn additional compensation if specific performance objectives are met. The time period for achievement of the objectives may vary from less than a year to a multiple year period. In each case, the performance objectives are designed to align the interests of executives with the interests of shareholders, and encourage executives to think and act as owners.

The Committee implemented a special incentive program for executive officers of the Company at the beginning of fiscal 2003. Awards under this special incentive program were tied to the Company achieving two key business performance objectives by the end of fiscal 2004. The two

performance objectives were (1) attainment of a fixed charge coverage ratio of 2 to 1 (under the fixed charge coverage test contained in the Company's bond indentures) in order to enable the Company to resume paying a dividend (if the Board so chooses) and (2) reduction in Company debt (public bonds) and/or accumulation of cash on the balance sheet totaling an aggregate of at least \$120 million. The potential payout to each executive officer for the achievement of the performance objectives would have been a cash amount equaling 50% of the officer's respective base salary (at the time of achievement) for each objective achieved (i.e., 50% of salary upon achievement of objective #1 and 50% of salary upon achievement of objective #2). After the conclusion of fiscal 2004, the Committee determined that the specified performance objectives were not met, and therefore no compensation was paid to executives under this special incentive program.

### **Stock Ownership and Retention Guidelines**

To further tie the financial interests of Company executives to those of shareholders, the Committee has established stock ownership and retention guidelines. Under these guidelines, executive officers are expected to accumulate shares (unrestricted) of the Company's common stock having a value equaling 1.5 times base salary in the case of the Chief Executive Officer and 1 times base salary in the case of the other executive officers (based on salaries at the time the guidelines were adopted). The goal is for executives to reach this ownership level by January 2009. To facilitate accomplishing the goal, executive officers generally are expected to retain at least one-half of the net after-tax shares (i.e., the net shares remaining after first selling sufficient shares to cover the anticipated tax liability and, in the case of stock options, the exercise price) obtained upon the vesting of restricted stock and the exercise of stock options.

Non-employee directors are not subject to specific ownership targets, but are expected to be shareholders of the Company. In addition, non-employee directors are expected to retain during their tenure all of the net after-tax shares obtained upon the vesting of restricted stock and at least one-half of the net after-tax shares obtained upon the exercise of stock options.

### **Chief Executive Officer Compensation**

Compensation decisions relating to Mr. Hendrix, as Chief Executive Officer, are made using the same methodology described above for all other executives. The Committee also evaluates his strategic vision and leadership capabilities, his ability to make decisions and implement plans that create competitive advantage and enhance shareholder value, and his overall effectiveness as a leader and role model.

Mr. Hendrix was paid a base salary of \$650,000 in fiscal 2004 (i.e., no increase over the amount set for him in February 2003). As with all other named executive officers, Mr. Hendrix was paid a bonus for 2004. Mr. Hendrix's financial objectives for his 2004 bonus (100% weight) were based on growth in operating income, cash flow, revenue

and earnings per share. Mr. Hendrix earned a 2004 bonus of \$593,450 based on the degree of achievement of target levels for these objectives.

In addition, Mr. Hendrix received restricted stock and stock option awards in fiscal 2004, with the vesting provisions described above under Long Term Incentives. The Committee believes that the equity incentives awarded to Mr. Hendrix in 2004 are designed to maintain a strong link between the financial interests of Mr. Hendrix and the Company's other shareholders.

### **Compensation Deductibility**

An income tax deduction under federal law will be generally available for annual compensation in excess of \$1 million paid to the chief executive officer and the named executive officers of a public corporation only if that compensation is performance-based and complies with certain other tax law requirements. Executive compensation under the Company's Executive Bonus Plan, described above, meets these requirements and therefore qualifies for an income tax deduction under federal law.

Although the Committee considers deductibility issues when approving executive compensation elements, the Company and the Committee believe that other compensation objectives, such as attracting, retaining and providing incentives to qualified managers, are important and may supersede the goal of maintaining deductibility. Consequently, the Company and the Committee may make compensation decisions without regard to deductibility when it is deemed to be in the best interests of the Company and its shareholders to do so.

The foregoing policies and programs are subject to change as the Committee deems necessary from time to time to respond to economic conditions, meet competitive standards and serve the objectives of the Company and its shareholders.

## THE COMPENSATION COMMITTEE

Thomas R. Oliver (Chair)  
 June M. Henton  
 Christopher G. Kennedy

**Compensation Committee Interlocks and Insider Participation**

None of the executive officers of the Company served as either (1) a member of the Compensation Committee or (2) a director of any entity of which any member of the Compensation Committee is an executive officer. In addition, none of the executive officers of the Company served as a member of the compensation committee of any entity of which any member of the Board of Directors is an executive officer.

17

**STOCK PERFORMANCE**

The following graph and table compare, for the five-year period ended January 2, 2005, the Company's total return to shareholders (stock price increase plus dividends, divided by beginning stock price) with that of (i) all U.S. companies listed on The Nasdaq Stock Market, and (ii) a self-determined peer group comprised primarily of companies in the commercial interiors industry.

**Comparison of Five Year Cumulative Total Returns (\$)**

	<u>1/02/00</u>	<u>12/31/00</u>	<u>12/30/01</u>	<u>12/29/02</u>	<u>12/28/03</u>	<u>1/02/05</u>
Interface, Inc.	100.0	156.8	108.2	58.7	112.7	185.7
Nasdaq Stock Market (U.S. Companies)	100.0	60.3	48.8	33.4	48.8	53.8
Self-Determined Peer Group	100.0	85.2	91.6	87.6	121.0	157.7

## Notes:

- A. The lines represent annual index levels derived from compounded daily returns that include all dividends.
- B. The indices are re-weighted daily, using the market capitalization on the previous trading day.
- C. If the annual interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.
- D. The index level was set to \$100 as of 1/02/00 (the last day of fiscal 1999).
- E. The Company's fiscal year ends on the Sunday nearest December 31.
- F. The following companies are included in the self-determined peer group: Actuant Corporation (formerly known as Applied Power, Inc.); Armstrong Holdings, Inc.; BE Aerospace, Inc.; Burlington Industries, Inc.; The Dixie Group, Inc.; Hon Industries Inc.; Herman Miller, Inc.; Kimball International, Inc.; Mohawk Industries, Inc.; and USG Corp. Burlington Industries, Inc. and Armstrong Holdings, Inc., which filed Chapter 11 bankruptcy petitions in 2001 and 2002, respectively, have been in the Company's self-determined peer group for each of the past five years, and are included again this year to provide more consistent benchmarking with respect to the self-determined peer group.

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**SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers, and persons who own more than 10% of a registered class of the Company's equity securities, to file with the Securities and Exchange Commission and the Nasdaq Stock Market reports of ownership and changes in ownership of Common Stock and other equity securities of the Company. Directors, executive officers and greater than 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such reports furnished to the Company or written representations that no other reports were required, the Company believes that during fiscal 2004 all filing requirements applicable to its directors, executive officers and greater than 10% beneficial owners were met except that Christopher J. Richard, a Vice President of the Company, filed a late Form 4 with respect to a purchase of 450 shares; and Daniel T. Hendrix, President, Chief Executive Officer and a Director of the Company, filed a Form 5 for fiscal 2004 with respect to a sale of 431 shares (triggered by a loan taken from his 401(k) plan account) that was not reported on a timely basis on Form 4.

**INFORMATION CONCERNING THE COMPANY'S ACCOUNTANTS**

BDO Seidman, LLP served as the independent auditors for the Company during fiscal 2004, and has been selected by the Audit Committee of the Board of Directors to be the independent auditors for the Company during fiscal 2005. Representatives of BDO Seidman, LLP are expected to be present at the annual meeting and will have the opportunity to make a statement, if they desire to do so, and to respond to appropriate questions.

**Audit Fees**

The aggregate fees billed the Company by BDO Seidman, LLP for audit services totaled approximately \$3,052,000 for fiscal 2004 and \$1,736,000 for fiscal 2003, including fees associated with the Company's annual audits and reviews of the Company's quarterly reports on Form 10-Q.

**Audit Related Fees**

Fees for audit related services provided by BDO Seidman, LLP totaled approximately \$12,000 for fiscal 2004 and \$19,000 for fiscal 2003. Audit related services principally include research regarding technical accounting issues and the audit of the Company's 401(k) plan.

**Tax Fees**

Fees for tax services provided by BDO Seidman, LLP, including tax compliance, tax advice and tax planning, totaled approximately \$308,000 for fiscal 2004 and \$293,000 for fiscal 2003.

**All Other Fees**

BDO Seidman, LLP provided no services for the Company other than those described above in either fiscal 2004 or 2003.

**Approval of Audit and Non-Audit Services**

The Audit Committee pre-approves all audit and non-audit services performed by the Company's independent auditor.

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**AUDIT COMMITTEE REPORT**

The Audit Committee operates pursuant to an Audit Committee Charter that was adopted by the Board of Directors. (A copy of the Audit Committee Charter may be viewed on the Company's website, [www.interfaceinc.com](http://www.interfaceinc.com).) The Company's management is responsible for its internal

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accounting controls and the financial reporting process. The Company's independent accountants, BDO Seidman, LLP, are responsible for performing an audit of the Company's consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) and for expressing an opinion as to their conformity with generally accepted accounting principles. The Audit Committee's responsibility is to monitor and oversee these processes.

In keeping with that responsibility, the Audit Committee has reviewed and discussed the Company's audited consolidated financial statements with management and BDO Seidman, LLP. In addition, the Audit Committee has discussed with BDO Seidman, LLP the matters required to be discussed by Statement on Auditing Standards No. 61, Communications with Audit Committee, as currently in effect. In addition, the Audit Committee has received the written disclosures from BDO Seidman, LLP required by Independence Standards Board Standard No. 1,

Independence Discussions with Audit Committees, and has discussed with the independent accountants their independence. The Audit Committee has also considered whether the provision of those services discussed above under the caption Information Concerning the Company's Accountants All Other Fees by BDO Seidman, LLP is compatible with maintaining BDO Seidman, LLP's independence.

The Board of Directors, in its business judgment, has determined that all three members of the Audit Committee are independent, as required by applicable listing standards of Nasdaq as currently in effect. Although the members of the Audit Committee are not professionally engaged in the practice of auditing or accounting and are not experts in the fields of auditing or accounting (including in respect of auditor independence), the Board of Directors has determined that each member does qualify as an audit committee financial expert as defined by Item 401(h) of Regulation S-K. Members of the Audit Committee rely, without independent verification, on the information provided to them and on the representations made by management and BDO Seidman, LLP. Accordingly, the Audit Committee's oversight does not provide an independent basis to determine that management has followed appropriate accounting and financial reporting principles or maintained appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's considerations and discussions referred to above do not assure that the audit of the Company's financial statements has been carried out in accordance with the standards of the Public Company Accounting Oversight Board (United States), that the financial statements are presented in accordance with generally accepted accounting principles or that the Company's auditors are independent.

Based on the reports and discussions described in this report, and subject to the limitations on the role and responsibilities of the Audit Committee referred to above and in the Audit Committee Charter, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements of the Company be included in the Company's annual report on Form 10-K for the year ended January 2, 2005 for filing with the Securities and Exchange Commission.

### THE AUDIT COMMITTEE

Carl I. Gable (Chair)  
Edward C. Callaway  
James B. Miller, Jr.

20

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### SHAREHOLDER PROPOSALS

Proposals of shareholders intended to be presented at the Company's 2006 annual meeting must be received by the Company no later than December 20, 2005, in order to be eligible for inclusion in the Company's Proxy Statement and form of Proxy for that meeting. In addition, in accordance with Article II, Section 9, of the Bylaws of the Company, proposals of shareholders intended to be presented at the Company's 2006 annual meeting must be presented to the Board of Directors by no later than 90 days prior to that annual meeting, with such deadline for presentation of proposals estimated to be February 17, 2006.

### COMMUNICATING WITH THE BOARD

Shareholders wishing to communicate with the Board of Directors may send communications via U.S. mail to the following address:

Chairman of the Board  
Interface, Inc.  
2859 Paces Ferry Road  
Suite 2000  
Atlanta, GA 30339

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From time to time, the Board may change the process by which shareholders may communicate with the Board or its members. The Company's website, www.interfaceinc.com, will reflect any changes to the process.

Attendance of Board members at annual meetings is left to the discretion of each individual Board member. Nine Board members attended the 2004 annual meeting.

**HOUSEHOLDING OF PROXY MATERIALS**

The Securities and Exchange Commission has adopted rules that permit companies and intermediaries such as brokers to satisfy delivery requirements for proxy statements with respect to two or more shareholders sharing the same address by delivering a single proxy statement addressed to those shareholders. This process, which is commonly referred to as householding, potentially provides extra convenience for shareholders and cost savings for companies. The Company and some brokers household proxy materials, delivering a single proxy statement to multiple shareholders sharing an address unless contrary instructions have been received from the affected shareholders. Once you have received notice from your broker or us that they or we will be householding materials to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, please notify your broker if your shares are held in a brokerage account or us if you hold shares as the registered holder. You can notify us by sending a written request to Interface, Inc., Attn: Secretary, 2859 Paces Ferry Road, Suite 2000, Atlanta, Georgia 30339.

**OTHER MATTERS THAT MAY COME BEFORE THE MEETING**

The Company knows of no matters other than those stated above that are to be brought before the meeting. However, if any other matter should be properly presented for consideration and voting, it is the intention of the persons named as proxies in the enclosed Proxy to vote the Proxy in accordance with their judgment of what is in the best interest of the Company.

By order of the Board of Directors

RAYMOND S. WILLOCH  
*Secretary*

April 15, 2005

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**CLASS A COMMON STOCK  
INTERFACE, INC.**

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS FOR  
THE 2005 ANNUAL MEETING OF SHAREHOLDERS**

The undersigned hereby appoints Ray C. Anderson and Daniel T. Hendrix, or either of them, with power of substitution to each, the proxies of the undersigned to vote the Class A Common Stock of the undersigned at the

Annual Meeting of Shareholders of Interface, Inc. to be held on May 19, 2005, and any adjournment thereof.

THE BOARD OF DIRECTORS FAVORS A VOTE **FOR** PROPOSAL 1 (ELECTION OF DIRECTORS), AND, UNLESS INSTRUCTIONS TO THE CONTRARY ARE INDICATED IN THE SPACES PROVIDED, THIS PROXY WILL BE SO VOTED.

**PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.**

Please sign and date this Proxy exactly as name appears. NOTE: When signing as an attorney, trustee, administrator or guardian, please give your title as such. In the case of joint tenants, each joint owner must sign.

**INTERFACE, INC.  
C/O EQUISERVE TRUST COMPANY, N.A.  
P.O. BOX 8694  
EDISON, NJ 08818-8694**

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**Please mark  
X vote as in  
this example.**

**INTERFACE, INC.  
CLASS A COMMON STOCK**

1. Election of Directors.

**Nominees:** (01) Dianne Dillon-Ridgley, (02) June M. Henton,  
(03) Christopher G. Kennedy, (04) James B. Miller,  
Jr.,  
(05) Thomas R. Oliver

**FOR  
ALL  
NOMINEES**   

**WITHHELD  
FROM ALL  
NOMINEES**   

For all nominees except as noted above

2. In accordance with their best judgment, with respect to any other matters that may properly come before the meeting.

**THE BOARD OF DIRECTORS  
FAVORS A VOTE FOR THE  
ELECTION OF THE LISTED  
NOMINEES.**

Please be sure to sign and date this Proxy.

Signature: _____	Date: _____	Co-Owner Signature: _____	Date: _____
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**CLASS B COMMON STOCK  
INTERFACE, INC.**

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS FOR  
THE 2005 ANNUAL MEETING OF SHAREHOLDERS**

The undersigned hereby appoints Ray C. Anderson and Daniel T. Hendrix, or either of them, with power of substitution to each, the proxies of the undersigned to vote the Class B Common Stock of the undersigned at the Annual Meeting of Shareholders of Interface, Inc. to be held on May 19, 2005, and any adjournment thereof.

THE BOARD OF DIRECTORS FAVORS A VOTE **FOR** PROPOSAL 1 (ELECTION OF DIRECTORS), AND, UNLESS INSTRUCTIONS TO THE CONTRARY ARE INDICATED IN THE SPACES PROVIDED, THIS PROXY WILL BE SO VOTED.

**PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.**

Please sign and date this Proxy exactly as name appears. NOTE: When signing as an attorney, trustee, administrator or guardian, please give your title as such. In the case of joint tenants, each joint owner must sign.

**INTERFACE, INC.  
C/O EQUISERVE TRUST COMPANY, N.A.  
P.O. BOX 8694  
EDISON, NJ 08818-8694**

DETACH HERE

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Please mark  
 vote as in  
this example.

#IFC

**INTERFACE, INC.  
CLASS B COMMON STOCK**



1. Election of Directors.

**Nominees:** (01) Ray C. Anderson, (02) Edward C. Callaway,  
(03) Carl I. Gable, (04) Daniel T. Hendrix,  
(05) J. Smith Lanier, II, (06) Clarinus C. Th. van  
Andel

**FOR**  
**ALL**   **WITHHELD**  
**NOMINEES**   **FROM ALL**  
**NOMINEES**

For all nominees except as noted above

2. In accordance with their best judgment, with respect to any other matters that may properly come before the meeting.

**THE BOARD OF DIRECTORS  
FAVORS A VOTE FOR THE  
ELECTION OF THE LISTED  
NOMINEES.**

Please be sure to sign and date this Proxy.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_ Co-Owner  
Signature: \_\_\_\_\_ Date: \_\_\_\_\_