SANMINA-SCI CORP
Form 10-Q
May 04, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

or

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission File Number 0-21272

Sanmina-SCI Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**77-0228183** (I.R.S. Employer Identification Number)
2700 N. First St., San Jose, CA (Address of principal executive offices)	**95134** (Zip Code)

(408) 964-3500

(Registrant s telephone number, including area code)

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

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Yes o No x

As of April 23, 2007, there were 529,884,856 shares outstanding of the issuer s common stock, $0.01 par value per share.

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CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2007 (Unaudited) (In thousands)	September 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 664,092	$ 491,829
Accounts receivable, net of allowances of $10,213 and $8,971, at March 31, 2007 and September 30, 2006, respectively	1,408,198	1,526,373
Inventories	1,217,113	1,318,400
Prepaid expenses and other current assets	152,948	154,401
Total current assets	3,442,351	3,491,003
Property, plant and equipment, net	617,357	620,132
Other intangible assets, net	26,017	29,802
Goodwill	1,614,551	1,613,230
Other non-current assets	78,420	94,512
Restricted cash	13,194	13,751
Total assets	$ 5,791,890	$ 5,862,430
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,375,463	$ 1,494,603
Accrued liabilities	192,661	223,263
Accrued payroll and related benefits	144,894	156,248
Current portion of long-term debt	700,114	100,135
Total current liabilities	2,413,132	1,974,249
Long-term liabilities:		
Long-term debt, net of current portion	985,964	1,507,218
Other	107,901	110,400
Total long-term liabilities	1,093,865	1,617,618
Commitments and contingencies		
Stockholders equity:		
Common stock	5,487	5,519
Treasury stock	(185,583)	(186,361)
Additional paid-in capital	5,959,325	5,952,857
Accumulated other comprehensive income	47,607	42,608
Accumulated deficit	(3,541,943)	(3,544,060)
Total stockholders equity	2,284,893	2,270,563
Total liabilities and stockholders equity	$ 5,791,890	$ 5,862,430

See accompanying notes.

SANMINA-SCI CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(Unaudited) (In thousands, except per share data)			
Net sales	$ 2,611,689	$ 2,668,418	$ 5,390,479	$ 5,530,215
Cost of sales	2,473,969	2,503,859	5,084,081	5,197,169
Gross profit	137,720	164,559	306,398	333,046
Operating expenses:				
Selling, general and administrative	93,496	87,049	189,814	177,152
Research and development	8,971	10,434	17,933	19,481
Amortization of intangible assets	1,611	2,071	3,261	4,304
Restructuring costs	18,947	20,593	22,162	56,221
Total operating expenses	123,025	120,147	233,170	257,158
Operating income	14,695	44,412	73,228	75,888
Interest income	8,671	5,091	19,571	11,016
Interest expense	(45,780)	(30,724)	(89,111)	(63,676)
Loss on extinguishment of debt		(84,600)		(84,600)
Other income (expense), net	(553)	(3,682)	10,408	(9,389)
Interest and other expense, net	(37,662)	(113,915)	(59,132)	(146,649)
Income (loss) before income taxes and cumulative effect of accounting change	(22,967)	(69,503)	14,096	(70,761)
Provision for (benefit from) income taxes	3,165	6,559	11,979	(6,398)
Income (loss) before cumulative effect of accounting change	(26,132)	(76,062)	2,117	(64,363)
Cumulative effect of accounting change, net of tax				5,695
Net income (loss)	$ (26,132)	$ (76,062)	$ 2,117	$ (58,668)
Net income (loss) per share before cumulative effect of accounting change:				
Basic	$ (0.05)	$ (0.14)	$ 0.00	$ (0.12)
Diluted	$ (0.05)	$ (0.14)	$ 0.00	$ (0.12)
Net income (loss) per share:				
Basic	$ (0.05)	$ (0.14)	$ 0.00	$ (0.11)
Diluted	$ (0.05)	$ (0.14)	$ 0.00	$ (0.11)
Weighted average shares used in computing per share amounts:				
Basic	527,101	525,256	527,106	524,784
Diluted	527,101	525,256	528,570	524,784

See accompanying notes.

SANMINA-SCI CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(Unaudited) (In thousands)	
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income (loss)	$ 2,117	$ (58,668)
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	59,713	71,601
Restructuring (recovery of) non-cash costs	(3,753)	21,069
Provision for (recovery of) doubtful accounts	1,242	(571)
Stock-based compensation	6,054	5,736
Gain on disposal of property, plant and equipment, net	(6,312)	(902)
Loss on interest rate swap		5,464
Cumulative effect of accounting changes, net		(5,695)
Proceeds from sale of accounts receivable	976,868	694,772
Loss on extinguishment of debt		84,600
Other, net	56	701
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(852,773)	(654,204)
Inventories	108,349	(129,113)
Prepaid expenses and other current and non-current assets	3,689	4,346
Accounts payable and accrued liabilities	(166,690)	(172,903)
Restricted cash	1,146	
Income tax accounts	(5,682)	(21,666)
Cash provided by (used in) operating activities	124,024	(155,433)
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchases of long-term investments	(250)	(748)
Purchases of property, plant and equipment	(40,398)	(70,101)
Proceeds from sale of property, plant and equipment	30,819	7,426
Cash paid for businesses acquired, net of cash acquired	(4,172)	(44,644)
Purchases of short-term investments		(17,755)
Proceeds from maturities and sale of short-term investments		74,796
Cash used in investing activities	(14,001)	(51,026)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:		
Change in restricted cash		22,460
Payments of long-term debt	(525,000)	(750,929)
Proceeds from long-term debt, net of issuance cost	593,409	587,123
Issuance of convertible debentures		(543)
Interest rate swap termination associated with debt extinguishment		(29,785)
Redemption premium associated with debt extinguishment		(70,751)
Payments of notes and credit facilities, net	(104)	(455)
Proceeds from sale of common stock	382	12,109
Cash provided by (used in) financing activities	68,687	(230,771)
Effect of exchange rate changes	(6,447)	(5,617)
Increase (decrease) in cash and cash equivalents	172,263	(442,847)
Cash and cash equivalents at beginning of period	491,829	1,068,053
Cash and cash equivalents at end of period	$ 664,092	$ 625,206
Supplemental disclosures of cash flow information:		
Cash paid during the period		
Interest	$ 79,161	$ 71,749
Income taxes	$ 20,966	$ 25,407

See accompanying notes.

SANMINA-SCI CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of Sanmina-SCI Corporation (Sanmina-SCI , we , our , the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules or regulations. The interim financial statements are unaudited, but reflect all normal recurring adjustments and non-recurring adjustments that are, in the opinion of management, necessary for a fair presentation.

The results of operations for the six months ended March 31, 2007, is not necessarily indicative of the results that may be expected for the full fiscal year. We have restated our Condensed Consolidated Financial Statements for the six month period ended April 1, 2006, refer to our 2006 Annual Report on Form 10-K for more information.

These Condensed Consolidated Financial Statements should be read in conjunction with the financial statements and notes thereto for the year ended September 30, 2006, included in our 2006 Annual Report on Form 10-K.

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Accounting Pronouncements

On September 13, 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements . SAB No. 108, addresses quantifying the financial statement effects of misstatements; specifically, how the effects of prior year uncorrected misstatements must be considered in quantifying misstatements in the current year financial statements. In addition, SAB No. 108 provides guidance on the correction of misstatements, including the correction of prior period financial statements for immaterial misstatements. Importantly, SAB No. 108 offers a one-time special transition provision for correcting certain prior year misstatements that were uncorrected as of the beginning of the fiscal year of adoption. SAB No. 108 is effective for fiscal years ended after November 15, 2006. We expect to adopt this standard during the fourth quarter of fiscal year 2007, effective as of the beginning of fiscal year 2008. We are currently reviewing this bulletin to determine the potential impact to our financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106 and 132(R). The statement requires an employer to recognize in its statement of financial position an asset for a plan s over-funded status or a liability for a plan s under-funded status. The measurement date of the plans assets and obligations that determine the funded status will be as of the end of the Company s fiscal year. The statement will be effective as of the end of fiscal 2007. We are currently reviewing this statement to determine the potential impact to our financial position, results of operations, and related cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. The interpretation contains a two step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The provisions are effective for the Company beginning in the first quarter of fiscal 2008. The Company is currently evaluating the impact this statement will have on its consolidated financial statements.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) Issue 06-3, How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement, (EITF 06-3). In EITF

06-3 a consensus was reached that entities may adopt a policy of presenting taxes assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, including but not limited to sales and value-added taxes in the income statement on either a gross or net basis. If an entity reports these taxes on a gross basis, the entity should disclose its policy of presenting taxes and the amount of taxes if reflected on a gross basis in the income statement if that amount is significant. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. This statement is effective immediately. The Company presents revenues net of sales and value-added taxes in its Condensed Consolidated Statement of Operations. The Company does not anticipate any impact to its financial position, results of operations, and related cash flows from the adoption of EITF 06-3.

Note 2. Stock-Based Compensation

Effective October 2, 2005, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with the SFAS No. 123R. Compensation cost associated with equity compensation recognized during the three and six months ended March 31, 2007 and April 1, 2006, includes: 1) stock-based compensation cost related to equity-based awards granted prior to October 2, 2005 that vested, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and 2) stock-based compensation cost expensing of all stock option awards granted subsequent to October 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. The compensation expense for stock based compensation awards includes an estimate for forfeitures and is recognized over the vesting term using the ratable method. The Company recorded a cumulative effect benefit adjustment for estimated forfeitures of approximately $5.7 million for previously issued restricted stock and stock options upon the adoption of SFAS No. 123R during the six month period ended April 1, 2006.

Total stock compensation expense (excluding the $5.7 million benefit recorded on cumulative effect of accounting change) for the three and six months ended March 31, 2007 and April 1, 2006 (restated), respectively, are represented by expense categories in the table below:

	Three Months Ended		**Six Months Ended**	
	March 31, 2007	**April 1, 2006 (Restated)**	**March 31, 2007**	**April 1, 2006 (Restated)**
Cost of sales	$ 1,214	$ 274	$ 2,252	$ 2,860
Selling, general & administrative.	2,104	(1,213)	3,606	2,571
Research & development	101	56	196	305
	$ 3,419	$ (883)	$ 6,054	$ 5,736

Stock Options

The Company s stock option plans provide its employees the right to purchase common stock at the fair market value of such shares on the grant date. The Company amortizes its stock options over the vesting period which is generally five years. New hire options vest 20% at the end of year one and then vest ratably each month, thereafter, for the remaining four years. Recurring option grants vest ratably each month over a five-year period. One year option grants vest ratably each month over a one year period. The contract term of the options is ten years. For all option grants prior to the adoption of SFAS No. 123R, the Company recognizes compensation cost using the multiple option approach. For all option grants subsequent to the adoption of SFAS No. 123R, the Company recognizes compensation cost ratably (straight-line) over the service period.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected life of options is based on observed historical exercise patterns. The expected volatility is an equally weighted blend of implied volatilities from traded options on our stock having a life of more than one year and historical volatility over the expected life of the options. The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that we have not paid any dividends and have no intention to pay dividends in the foreseeable future.

The assumptions used for options granted during the three and six months ended March 31, 2007 and April 1, 2006 are presented below:

	Three Months Ended		Six Months Ended	
	March 31, 2007	April 1, 2006	March 31, 2007	April 1, 2006
Volatility	53.8 %	60.0 %	55.1 %	57.0 %
Risk-free interest rate	4.67 %	4.55 %	4.64 %	4.45 %
Dividend yield	0 %	0 %	0 %	0 %
Expected life of options	5.5 years	5.7 years	5.5 years	5.6 years

The Company recorded approximately $840,000 and $641,000 of compensation expense related to stock options for the three months ended March 31, 2007 and April 1, 2006 (restated), respectively, in accordance with SFAS No. 123R. The Company recorded approximately $1.7 million and $4.0 million of compensation expense related to stock options for the six months ended March 31, 2007 and April 1, 2006 (restated), respectively, in accordance with SFAS No. 123R. A summary of stock option activity under the plans for the three and six months ended March 31, 2007, is presented as follows:

Summary Details for Plan Share Options

	Number of Options	Weighted-Average Exercise Price ($)	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value of In-The-Money Options ($)
Outstanding, September 30, 2006	50,713,754	8.47	6.22	458,342
Granted	103,500	3.94		
Exercised				
Cancelled/Forfeited/Expired	(4,121,288)	6.94		
Outstanding, December 30, 2006	46,695,966	8.60	6.15	320,953
Exercisable, December 30, 2006	40,441,678	9.30	5.73	270,820
Granted	5,679,650	3.71		
Exercised				
Cancelled/Forfeited/Expired	(2,287,572)	7.83		
Outstanding, March 31, 2007.	50,088,044	8.08	6.40	445,102
Vested and expected to vest, March 31, 2007	47,725,043	8.29	6.25	419,736
Exercisable, March 31, 2007	39,045,981	9.26	5.56	326,560

The weighted-average grant date fair value of stock options granted during the three and six months ended March 31, 2007, was $1.99 and $2.00, respectively. The weighted-average grant date fair value of stock options granted during the three and six months ended April 1, 2006 (restated) was $2.41 and $2.23, respectively. There were no stock options exercised during the three and six months ended March 31, 2007. The total intrinsic value of stock options exercised during the three and six months ended April 1, 2006 (restated) was $222,000 and $2.6 million, respectively. The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value of in-the-money options based on the Company s closing stock price of $3.62 as of March 31, 2007, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable as of March 31, 2007 was 289,949 and the weighted average exercise price was $2.49.

At March 31, 2007, an aggregate of 70.2 million shares were authorized for future issuance under our stock plans, which covers stock options, employee stock purchase plans, and restricted stock awards. A total of 7.9 million shares of common stock were available for grant under our stock option plans as of March 31, 2007. Awards that expire or are cancelled without delivery of shares generally become available for issuance under the plans.

As of March 31, 2007, there was $27.3 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 4.36 years.

On December 31, 2006, the Company adjusted the exercise price of option grants held by Section 16 officers to equal the fair market value at the measurement date of the original grant. This was done to avoid negative tax consequences under IRC Section 409A. There were eleven directors and Section 16 officers who elected to take advantage of this remediation and the exercise price of 998,146 shares was adjusted. There was no incremental compensation cost resulting from the modification. The weighted average exercise price of the shares before the modification was approximately $9.76. The weighted average exercise price after the modification was approximately $12.41.

On March 19, 2007, the Company commenced a tender offer to exchange certain options to purchase shares of its common stock, whether vested or unvested, for new options that will be granted under its 1999 Stock Plan. The exchange ratio for this offer will range from one (1) to three (3) exchanged options for every one (1) new option granted. This tender offer will expire on May 15, 2007 unless extended and is subject to the terms and conditions set forth in the Offer to Exchange Certain Outstanding Options for New Options, dated March 19, 2007, which was filed with the Securities Exchange Commission on March 19, 2007. If all eligible options are exchanged, then 23,041,735 existing options will be cancelled and 19,137,035 new options will be granted. The purpose of this exchange is to mitigate the exposure with respect to Internal Revenue Code Section 409A. For more information, refer to our Tender Offer Statement filings with the Securities and Exchange Commission on April 13, 2007 and April 30, 2007.

Employee Stock Purchase Plan

In fiscal 2003, the Board of Directors and stockholders of the Company approved the 2003 Employee Stock Purchase Plan (the 2003 ESPP). The maximum number of shares of common stock available for issuance under the 2003 ESPP is nine million shares. On February 27, 2006 an additional six million shares were reserved under the 2003 Employee Stock Purchase Plan. Under the 2003 ESPP, employees may purchase, on a periodic basis, a limited number of shares of common stock through payroll deductions over a six-month period. The per share purchase price is 85% of the fair market value of the stock at the beginning or end of the offering period, whichever is lower.

The Company has treated the Employee Stock Purchase Plan as a compensatory plan and have recorded compensation expense of approximately $600,000 and $1.9 million for the three and six months ended April 1, 2006 (restated), respectively, in accordance with SFAS No. 123R. As a result of the stock option investigation, which has recently been concluded, the Company suspended the ESPP. The Company plans to re-activate the ESPP in the future. The Company did not record compensation expense for ESPP during the three and six months ended March 31, 2007.

The assumptions used for the three and six months ended April 1, 2006 are presented below:

	Three Months Ended April 1, 2006 (Restated)		**Six Months Ended April 1, 2006 (Restated)**	
Volatility	50.0	%	51.0	%
Risk-free interest rate	4.59	%	4.48	%
Dividend yield	0	%	0	%
Expected life	0.75 years		0.75 years	

Restricted Stock Awards

The Company grants awards of restricted stock to executive officers, directors and certain management employees. These awards vest at various periods ranging from one to four years.

Compensation expense computed for the three and six months ended March 31, 2007 was approximately $1.8 million and $3.3 million, respectively. Compensation expense computed for the three and six months ended April 1, 2006 (restated) was approximately $980,000 and $2.8 million, respectively.

There were no restricted stock awards granted during the three and six month periods ended March 31, 2007. There were 103,698 restricted stock awards granted during the three and six month periods ended April 1, 2006 (restated). The weighted-average grant date fair value of the restricted stock awards granted during the three and six month periods ended April 1, 2006 (restated) was $3.90 for both periods. At March 31, 2007, unrecognized cost related to restricted stock awards totaled approximately $5.7 million. These costs are expected to be recognized over a weighted average period of 0.61 year.

A summary of the status of the Company s nonvested restricted shares for the three and six months ended March 31, 2007 is presented below:

	Number of Shares	Weighted Average Grant-Date Fair Value ($)
Nonvested at September 30, 2006	3,038,490	10.43
Granted		
Vested		
Forfeited	(100,000)	11.67
Nonvested at December 30, 2006	2,938,490	10.38
Granted		
Vested	(136,929)	6.17
Forfeited	(75,000)	11.67
Nonvested at March 31, 2007.	2,726,561	10.56

Restricted Stock Units

During fiscal year 2006, the Company began issuing restricted stock units to executive officers, directors and certain management employees. These awards vest at various periods ranging from one to four years. The units are automatically exchanged for shares at the vesting date.

Compensation expense computed based on the fair value of these awards for the three and six months ended March 31, 2007 was approximately $766,000 and $1.0 million, respectively. Compensation expense computed based on the fair value of these awards for the three and six months ended April 1, 2006 (restated), was approximately $9,000 and $14,000, respectively.

There were 4,627,074 restricted stock units granted during the three and six months ended March 31, 2007 and the weighted-average grant date fair value of the restricted stock units was $3.55 for both periods. During the three and six months ended April 1, 2006 (restated), there were 77,500 shares of restricted stock units and 2,667,000 shares of restricted stock units granted, respectively. The weighted-average grant date fair value of the restricted stock units was $4.38 and $4.03, respectively, during the three and six months ended April 1, 2006 (restated). At March 31, 2007, unrecognized cost related to restricted stock units totaled approximately $18.4 million. These costs are expected to be recognized over a weighted average period of 2.25 years.

A summary of the status of the Company s nonvested restricted share units for the three and six months ended March 31, 2007 are presented below:

	Number of Shares	Weighted-Grant Date Fair Value ($)	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic ($)
Non-vested restricted stock units at September 30, 2006	1,526,500	4.79	3.54	5,709,110
Granted				
Vested				
Cancelled	(41,250)	4.06		
Non-vested restricted stock units at December 30, 2006	1,485,250	4.10	3.29	5,124,112
Granted	4,627,074	3.55		
Vested				
Cancelled	(66,500)	4.85		
Non-vested restricted stock units at March 31, 2007	6,045,824	3.84	2.25	21,885,883
Non-vested restricted stock units expected to vest at March 31, 2007	3,775,203	3.83	2.25	13,666,236

Performance Restricted Share Plan

During the three months ended April 1, 2006, the Company s Compensation Committee approved the issuance of approximately 2.5 million performance restricted units at a weighted-average grant date fair value of $4.02 per unit to selected executives and other key employees. The units are automatically exchanged for vested shares when certain performance targets are met.

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The Company did not record any compensation expense related to the performance restricted shares for the three and six months ended March 31, 2007 as the Company did not meet the prescribed performance levels. The total unrecognized compensation expense to be recognized over the remaining two years would be approximately $7.5 million, assuming the performance targets are achieved.

The Company did not record any compensation expense related to the performance restricted shares during fiscal 2006 as the prescribed performance level was not met. This resulted in the forfeiture of approximately 597,375 performance restricted units.

Note 3. Derivative Instruments and Hedging Activities

The Company enters into short-term foreign currency forward contracts to hedge currency exposures associated with certain assets and liabilities denominated in foreign currencies. These contracts typically have maturities of three months or less. Further, these contracts are not designated as part of a hedging relationship in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133). At March 31, 2007 and September 30, 2006, the Company had open forward contracts to exchange various foreign currencies for U.S. dollars in the aggregate notional amount of $263.9 million and $403.4 million, respectively. The net unrealized loss on the contracts at March 31, 2007 was not material and was recorded in accrued liabilities on the Condensed Consolidated Balance Sheet. Realized gains and losses on forward exchange contracts are recognized in the Condensed Consolidated Statement of Operations in other income (expense), net. The net impact of these foreign exchange contracts was not material to the results of operations for the three and six months ended March 31, 2007 and April 1, 2006.

The Company also utilized foreign currency forward and option contracts to hedge certain forecasted foreign currency sales and cost of sales referred to as cash flow hedges which qualify for hedge accounting under SFAS No. 133. These contracts typically are less than 12 months. Gains and losses on these contracts related to the effective portion of the hedges are recorded in other comprehensive income until the forecasted transactions impact earnings. When the contracts expire, any amounts recorded in other comprehensive income are reclassified to earnings. Gains and losses related to the ineffective portion of the hedges are immediately recognized on the Condensed Consolidated Statement of Operations. At March 31, 2007 and September 30, 2006, the Company had forward and option contracts related to cash flow hedges in various foreign currencies in the aggregate notional amount of $49.5 million and $10.1 million, respectively. The net unrealized gain on the contracts at March 31, 2007 was not material and was recorded in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheets. The net impact of the foreign currency forward and option contracts was not material to the results of operations for the three and six months ended March 31, 2007 and April 1, 2006.

The Company entered into interest rate swaps in February 2005 to hedge its mix of short-term and long-term interest rate exposures. The aggregate notional amount of the combined swap transactions is $400.0 million. At March 31, 2007 and September 30, 2006, $14.1 million and $17.1 million, respectively, have been recorded in other long-term liabilities to record the fair value of the interest rate swap transactions, with a corresponding decrease to the carrying value of the 6.75% Notes on the Condensed Consolidated Balance Sheets.

The Company s foreign exchange forward and option contracts and interest rate swaps expose the Company to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company minimizes such risk by limiting the Company s counterparties to major financial institutions. The Company does not expect material losses as a result of default by counterparties.

Note 4. Inventories

The components of inventories, net of provisions, are as follows:

	As of March 31, 2007	**September 30, 2006**
	(In thousands)	
Raw materials	$ 884,922	$ 905,236
Work-in-process	173,419	262,449
Finished goods	158,772	150,715
Total	$ 1,217,113	$ 1,318,400

Note 5. Goodwill and Other Intangibles Assets

On a consolidated basis, goodwill increased from $1,613 million to $1,615 million primarily as a result of translation adjustments offset by a $3.6 million release of tax reserves related to a pre-merger acquisition by SCI Technologies Inc.

Goodwill information for each reporting unit is as follows (in thousands):

	As of September 30, 2006	Additions to Goodwill	As of March 31, 2007
Reporting units:			
Standard Electronic Manufacturing Services	$ 1,524,099	$ 1,321	$ 1,525,420
Personal Computing	89,131		89,131
Total	$ 1,613,230	$ 1,321	$ 1,614,551

The gross and net carrying values of other intangible assets at March 31, 2007 and September 30, 2006 are as follows (in thousands):

	As of March 31, 2007				As of September 30, 2006			
	Gross Carrying Amount (In thousands)	Impairment of Intangibles	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Impairment of Intangibles	Accumulated Amortization	Net Carrying Amount
Other intangible assets	$ 72,106	$ (7,928)	$ (38,161)	$ 26,017	$ 72,106	$ (7,928)	$ (34,376)	$ 29,802

The decrease in other intangible assets from September 30, 2006 to March 31, 2007 was due to amortization of approximately $3.7 million.

Estimated annual amortization expense for other intangible assets at March 31, 2007 is as follows:

Fiscal Years:	(In thousands)
2007 (remainder)	$ 3,807
2008	7,537
2009	4,992
2010	2,957
2011	2,866
Thereafter	3,858
	$ 26,017

Note 6. Comprehensive Income

SFAS No. 130, Reporting Comprehensive Income , establishes standards for the reporting of comprehensive income and its components. SFAS No. 130 requires companies to report comprehensive income that includes unrealized holding gains and losses and other items that have been excluded from net income (loss) and reflected instead in stockholders equity.

The components of other comprehensive income (loss) for the three and six months ended March 31, 2007 and April 1, 2006 were as follows:

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(In thousands)			
Net income (loss)	$ (26,132)	$ (76,062)	$ 2,117	$ (58,668)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(766)	9,708	4,989	(1,339)
Unrealized holding losses on derivative financial instruments	(16)	(7)	(16)	(240)

Minimum pension liability	(321)	(22)	26	(6)
Comprehensive income (loss)	$ (27,235)	$ (66,383)	$ 7,116	$ (60,253)

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Accumulated other comprehensive income, net of tax as applicable, consists of the following:

	As of March 31, 2007	September 30, 2006
	(In thousands)	
Foreign currency translation adjustment	$ 52,153	$ 47,164
Unrealized holding losses on derivative financial instruments	(16)	
Minimum pension liability	(4,530)	(4,556)
Total accumulated other comprehensive income	$ 47,607	$ 42,608

Note 7. Earnings Per Share

Basic earnings per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share includes dilutive common stock equivalents, using the treasury stock method, and assumes that the convertible debt instruments were converted into common stock upon issuance, if dilutive. While the conceptual computation of earnings per share is not changed by SFAS No. 123R (Share-Based Payment), the inclusion of compensation cost will affect the mechanics of the calculation. The compensation cost will be recognized under SFAS No. 123R only for awards that are expected to vest (determined by applying the pre-vesting forfeiture rate assumption), while all options or shares outstanding that have not been forfeited would be included in diluted earnings per share. The amount of stock-based compensation cost in the numerator includes a forfeiture rate assumption while the number of shares in the denominator does not.

The following table sets forth the calculation of basic and diluted income (loss) per share:

	Three Months Ended		Six Months Ended	
	March 31, 2007	April 1, 2006 (Restated)	March 31, 2007	April 1, 2006 (Restated)
	(In thousands, except per share data)			
Numerator:				
Income (loss) before cumulative effect of accounting change	$ (26,132)	$ (76,062)	$ 2,117	$ (64,363)
Cumulative effect of accounting change, net of tax				5,695
Net income (loss)	$ (26,132)	$ (76,062)	$ 2,117	$ (58,668)
Denominator:				
Weighted average number of shares basic	527,101	525,256	527,106	524,784
Effect of dilutive potential common shares			1,464	
Weighted average number of shares diluted	527,101	525,256	528,570	524,784
Net income (loss) per share before cumulative effect of accounting change				
basic	$ (0.05)	$ (0.14)	$ 0.00	$ (0.12)
diluted	$ (0.05)	$ (0.14)	$ 0.00	$ (0.12)
Net income (loss) per share				
basic	$ (0.05)	$ (0.14)	$ 0.00	$ (0.11)
diluted	$ (0.05)	$ (0.14)	$ 0.00	$ (0.11)

The following table summarizes the weighted average dilutive securities that were excluded from the above computation of diluted net income (loss) per share because their inclusion would have an anti-dilutive effect:

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
Employee stock options	46,825,981	51,958,155	47,197,942	53,180,189
Restricted stock	3,075,796	3,034,135	1,384,638	3,240,268
Shares issuable upon conversion of 4% notes				3,134
Shares issuable upon conversion of 3% notes		12,697,848	11,639,694	12,697,848
Total anti-dilutive shares	49,901,777	67,690,138	60,222,274	69,121,439

After-tax interest expense of $2.3 million and $2.7 million related to the 3% Convertible Subordinated Notes for the three months ended March 31, 2007 and April 1, 2006, respectively, were not included in the computation of diluted income per share because to do so would be anti-dilutive. After-tax interest expense of $5.0 million related to the 3% Convertible Subordinated Notes and $5.4 million related to the 3% Convertible Subordinated Notes and Zero Coupon Convertible Subordinated Debentures for the six months ended March 31, 2007 and April 1, 2006, respectively, were not included in the computation of diluted income per share because to do so would be anti-dilutive.

Note 8. Debt

Senior Unsecured Term Loan. On October 13, 2006, the Company entered into a Credit and Guaranty Agreement (the Term Loan Agreement) providing for a $600.0 million senior unsecured term loan which matures on January 31, 2008. The Company drew down the $600.0 million term loan simultaneously with the closing of the transaction.

The loan bears interest at the election of the Company at either the prime rate plus 1.5% or at an adjusted LIBOR rate plus 2.5%. On the 181st day after closing, the interest rate margins with respect to all loans will increase by 0.5% for the remaining life of the loans. Interest is payable quarterly in arrears with respect to prime rate loans. For LIBOR rate loans, interest is payable at the end of each interest period depending on the Company s election of the length of borrowing period (i.e. one month, three months or six months). Principal, together with accrued and unpaid interest, is due at maturity. In addition, the Company is required to make mandatory prepayments of principal with the net cash proceeds from the sale of certain assets and the incurrence of certain debt.

All of the Company s existing and future domestic subsidiaries will guaranty the obligations under the Term Loan Agreement, subject to some limited exceptions.

The Term Loan Agreement contains affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, certain reporting requirements in accordance with the agreement and compliance with applicable laws and regulations. Further, the Term Loan Agreement contains negative covenants limiting the ability of the Company and its subsidiaries, among other things, to incur debt, grant liens and make certain restricted payments. The events of default under the Term Loan Agreement include payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events.

As of March 31, 2007 and September 30, 2006, the Company had no other term loans.

8.125% Senior Subordinated Notes. On February 15, 2006, the Company issued $600 million aggregate principal amount of 8.125% Senior Subordinated Notes due 2016 (the 8.125% Notes). Interest is payable on the 8.125% Notes on March 1 and September 1 of each year beginning on September 1, 2006. The maturity date of the 8.125% Notes is March 1, 2016. Debt issuance costs are included in prepaid expenses and other current assets and other non-current assets and amortized on a straight-line basis over the life of the debt as interest expense. As of March 31, 2007, $1.9 million is included in prepaid expenses and other current assets and $15.3 million is included in other non-current assets. The difference between the amount of amortization calculated using the straight-line method as compared to the effective interest method was immaterial. The 8.125% Notes are unsecured and subordinated in right of payment to all of the Company s existing and future senior debt, as defined in the indenture under which the 8.125% Notes were issued.

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The Company may redeem the 8.125% Notes, in whole or in part, at any time prior to March 1, 2011, at a redemption price that is equal to the sum of (1) the principal amount of the 8.125% Notes to be redeemed, (2) accrued and unpaid interest on those 8.125% Notes to, but excluding, the redemption date and (3) a make-whole premium calculated in the manner specified in the Indenture for the 8.125% Notes. The Company may redeem the 8.125% Notes, in whole or in part, beginning on March 1, 2011, at declining redemption prices ranging from 104.063% to 100% of the principal amount of the 8.125% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, with the actual redemption price to be determined based on the date of redemption. At any time prior to March 1, 2009, the Company may redeem up to 35% of the 8.125% Notes with the proceeds of certain equity offerings at a redemption price equal to 108.125% of the principal amount of the 8.125% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, so long as after giving effect to any such redemption, at least 65% of the aggregate principal amount of the 8.125% Notes remains outstanding.

Following a change of control, as defined in the Indenture, the Company will be required to make an offer to repurchase all or any portion of the 8.125% Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest to, but excluding, the date of repurchase.

The 8.125% Notes Indenture includes covenants that limit the ability of the Company and its restricted subsidiaries to, among other things: incur additional debt, make investments and other restricted payments, pay dividends on capital stock, or redeem or repurchase capital stock or subordinated obligations; create specified liens; sell assets; create or permit restrictions on the ability of the Company s restricted subsidiaries to pay dividends or make other distributions to the Company; engage in transactions with affiliates; incur layered debt; and consolidate or merge with or into other companies or sell all or substantially all of the Company s assets. The restrictive covenants are subject to a number of important exceptions and qualifications set forth in the Indenture for the 8.125% Notes.

The 8.125% Notes Indenture provides for customary events of default, including:

- payment defaults;
- breaches of covenants;
- certain payment defaults at final maturity or acceleration of certain other indebtedness;
- failure to pay certain judgments;
- certain events of bankruptcy, insolvency and reorganization; and
- certain instances in which a guarantee ceases to be in full force and effect.

If any event of default occurs and is continuing, subject to certain exceptions, the trustee or the holders of at least 25% in aggregate principal amount of the then outstanding 8.125% Notes may declare all the 8.125% Notes to be due and payable immediately, together with any accrued and unpaid interest, if any, to the acceleration date. In the case of an event of default resulting from certain events of bankruptcy, insolvency or reorganization, such amounts with respect to the 8.125% Notes will be due and payable immediately without any declaration or other act on the part of the trustee or the holders of the 8.125% Notes.

On January 3, 2007, the Company and U.S. Bank National Association, as trustee, entered into a supplemental indenture to the indenture under which the Company s 8.125% Senior Subordinated Notes due 2016 were issued. As permitted by the indenture, the supplemental indenture released each of the note s guarantors from its respective obligations under its notes guarantee and the indenture.

6.75% Senior Subordinated Notes. On February 24, 2005, the Company issued $400 million aggregate principal amount of its 6.75% Senior Subordinated Notes due 2013 (the 6.75% Notes). Interest is payable on the 6.75% Notes on March 1 and September 1 of each year, beginning on September 1, 2005. The maturity date of the 6.75% Notes is March 1, 2013. In June 2005, the Company completed an exchange offer pursuant to which substantially all of the 6.75% Notes were exchanged for notes registered under the Securities Act of 1933. These notes evidence the same debt as the original 6.75% Notes and are issued and entitled to the benefits of the same indenture that governs the original the 6.75% Notes except that they are not subject to transfer restrictions.

The 6.75% Notes are unsecured and subordinated in right of payment to all of the Company s existing and future senior debt as defined in the 6.75% Notes Indenture. The Company may redeem the 6.75% Notes, in whole or in part, at any time prior to March 1, 2009, at a redemption price that is equal to the sum of (1) the principal amount of the 6.75% Notes to be redeemed, (2) accrued and unpaid interest to, but excluding, the redemption date on those 6.75% Notes and (3) a make-whole premium calculated in the manner specified in the 6.75% Notes Indenture. The Company may redeem the 6.75% Notes, in whole or in part, beginning on March 1, 2009, at declining redemption prices ranging from 103.375% to 100% of the principal amount, plus accrued and unpaid interest to, but excluding, the redemption date, with the actual redemption price to be determined based on the date of redemption. At any time prior to March 1, 2008, the Company may redeem up to 35% of the 6.75% Notes with the proceeds of certain equity offerings at a redemption price equal to 106.75% of the principal amount of the 6.75% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, so long as after giving effect to any such redemption, at least 65% of the aggregate principal amount of the 6.75% Notes remains outstanding.

Following a change of control, as defined in the 6.75% Notes Indenture, the Company will be required to make an offer to repurchase all or any portion of the 6.75% Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest to, but excluding, the date of repurchase.

The 6.75% Notes Indenture includes covenants that limit the Company s ability and the ability of its restricted subsidiaries to, among other things: incur additional debt, make investments and other restricted payments, pay dividends on capital stock, or redeem or repurchase capital stock or subordinated obligations; create specified liens; sell assets; create or permit restrictions on the ability of its restricted subsidiaries to pay dividends or make other distributions to the Company; engage in transactions with affiliates; incur layered debt; and consolidate or merge with or into other companies or sell all or substantially all of its assets. The restricted covenants are subject to a number of important exceptions and qualifications set forth in the 6.75% Notes Indenture.

The 6.75% Notes Indenture provides for customary events of default, including payment defaults, breaches of covenants, certain payment defaults at final maturity or acceleration of certain other indebtedness, failure to pay certain judgments, certain events of bankruptcy, insolvency and reorganization and certain instances in which a guarantee ceases to be in full force and effect. If any event of default occurs and is continuing, subject to certain exceptions, the trustee or the holders of at least 25% in aggregate principal amount of the then outstanding 6.75% Notes may declare all the 6.75% Notes to be due and payable immediately, together with any accrued and unpaid interest, if any, to the acceleration date. In the case of an event of default resulting from certain events of bankruptcy, insolvency or reorganization, such amounts with respect to the 6.75% Notes will be due and payable immediately without any declaration or other act on the part of the trustee or the holders of the 6.75% Notes.

On January 3, 2007, the Company and U.S. Bank National Association, as trustee, entered into a supplemental indenture to the indenture under which the Company s 6.75% Senior Subordinated Notes due 2013 were issued. As permitted by the indenture, the supplemental indenture released each of the note s guarantors from its respective obligations under its notes guarantee and the indenture.

3% Convertible Subordinated Notes due 2007. In March 2000, SCI issued $575.0 million aggregate principal amount of 3% Convertible Subordinated Notes due March 15, 2007, or 3% Notes. On October 13, 2006, SCI Systems, Inc., one of the Company s wholly-owned subsidiaries (SCI Systems), initiated, in accordance with the terms thereof, the satisfaction and discharge of the Indenture, dated as of March 15, 2000, by and between SCI Systems and the Bank of New York Trust Company, National Association, as trustee (as supplemented, the Indenture), pursuant to which SCI Systems issued its 3% Notes due 2007. As a result, $532.9 million in cash was deposited with the trustee which represented a portion of the proceeds obtained from the Senior Unsecured Term Loan entered into on October 13, 2006 and is equal to the principal and interest due on the 3% Notes at maturity on March 15, 2007. The $532.9 million was recorded as restricted cash and classified in the Condensed Consolidated Financial Statements as a current asset as of December 30, 2006. The restricted cash of $532.9 million was released by the trustee to pay the bondholders upon maturity of the 3% Notes on March 15, 2007. Accordingly, as of March 31, 2007, the 3% Notes were fully satisfied and discharged.

Senior Credit Facility. On October 26, 2004, the Company entered into a Credit and Guaranty Agreement (the Original Credit Agreement) providing for a $500 million senior secured revolving credit facility with a $150 million letter of credit sub-limit. The senior secured credit facility provided for a maturity date of October 26, 2007. The Company entered into an Amended and Restated Credit and Guaranty Agreement, dated as of December 16, 2005, among the Company, certain of its subsidiaries, as guarantors, and the lenders that are parties thereto from time to time (the Restated Credit Agreement). The Restated Credit Agreement amended and restated the Original Credit Agreement among other things, to:

- extend the maturity date from October 26, 2007 to December 16, 2008;
- amend the leverage ratio;
- permit the Company and the guarantors to sell domestic receivables pursuant to factoring or similar arrangements if certain conditions are met; and

- revise the collateral release provisions.

All of the Company s existing and future domestic subsidiaries guaranty the obligations under the Restated Credit Agreement, subject to some limited exceptions. The Company s obligations and the obligations of its subsidiaries under the credit facility are secured by: substantially all of its assets; substantially all of the assets of substantially all of its United States subsidiaries located in the United States; a pledge of all capital stock of substantially all of its United States subsidiaries; a pledge of 65% of the capital stock of certain of its and its United States subsidiaries first-tier foreign subsidiaries; and mortgages on certain domestic real estate.

The Restated Credit Agreement requires the Company to comply with a fixed charge coverage ratio and a ratio of total debt to earnings before income tax, depreciation and amortization (EBITDA). Additionally, the credit facility contains numerous affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, reporting requirements and compliance with applicable laws and regulations. Further, the credit facility contains negative covenants limiting the ability of the Company and its subsidiaries, among other things, to incur debt, grant liens, make acquisitions, make certain restricted payments, sell assets and enter into sale and lease back transactions. The events of default under the credit facility include payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events.

At any time the aggregate face amount of receivables sold by the Company and the guarantors together with any outstanding amounts exceeds the thresholds set forth in the Restated Credit Agreement, the revolving credit commitments for purposes of making loans and issuing letters of credit will be zero.

On October 13, 2006, the Company and the required lenders entered into an amendment for its Restated Credit Agreement to permit the Company to enter into the Senior Unsecured Term Loan described above. The amendment also revised the collateral release provision under the Restated Credit Agreement such that collateral (other than stock pledges and other collateral the Company requests not to be released) will be released at such time as specified conditions are met, including that the Company has repaid in full the outstanding amount under the Senior Unsecured Term Loan and its credit ratings meets specified thresholds. If following the release of any portion of the collateral pursuant to the provisions of the credit agreement described above, the Company s credit ratings fall below specified thresholds, then the Company is required to take such actions as are necessary to grant and perfect a security interest in the assets and properties that would at that time comprise the collateral if the relevant collateral documents were still in effect. On December 29, 2006, the Company entered into an amendment and waiver to the Restated Credit Agreement. Among other things, this amendment amended the minimum required levels for both financial covenants and certain related definitions. The fees in regards to the amendment and waiver were deferred and amortized over the debt period. The amount of the fees was immaterial to the consolidated financial statements.

There was approximately $100 million of loans outstanding under the Restated Credit Agreement at an average interest rate of 7.58% as of March 31, 2007. Additionally, the Company pays a commitment fee of 0.35% on the unused portion of the credit facility.

The Company is in compliance with its covenants for the above debt instruments as of March 31, 2007. However, the Company may be required to seek waivers or amendments to certain covenants for the above debt instruments if it is unable to comply with the requirements of the covenants in the future or if the Company takes actions such as the divestiture of strategic assets that are not permitted by the covenants.

Note 9. Sale of Accounts Receivable

Certain of the Company s subsidiaries have entered into agreements that permit them to sell specified accounts receivable. The purchase price for receivables sold under these agreements ranges from 95% to 100% of the face amount less a discount charge (based on LIBOR plus a percentage ranging from 0.4% to 1.5%) for the period from the date the receivable is sold to its collection date. Accounts receivable sales under these agreements were $498.5 million and $976.9 million for the three and six month periods ended March 31, 2007, respectively. The sold receivables are subject to certain limited recourse provisions. In accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liability, accounts receivable sold are removed from the Condensed Consolidated Balance Sheet and are reflected as cash provided by operating activities in the Condensed Consolidated Statement of Cash Flows. As of March 31, 2007, $320.5 million of sold accounts receivable remain subject to certain recourse provisions. The Company has not experienced any credit losses under these recourse provisions. The discount charge recorded during the period was not material to the Condensed Consolidated Financial Statements. The discount charge is recorded in selling, general and administrative expenses on the Condensed Consolidated Statement of Operations.

As part of the sale of accounts receivable, the Company had a retained ownership interest (i.e. 100% of the receivable face amount less the purchase price) of $10.3 million at March 31, 2007. The retained interest was included in prepaid and other current assets. The retained interest has subsequently been collected.

Note 10. Commitments and Contingencies

Litigation and other contingencies. The Company is a so-called nominal defendant party in multiple shareholder derivative lawsuits, the Securities and Exchange Commission (SEC) and the Department of Labor are conducting informal inquiries. The Company has received a subpoena from the U.S. Attorney s office and the Company has received an information document request from the Internal Revenue Service in connection with certain historical stock option grants. Presently, the Company is unable to predict the outcome of these matters. The resolution of these litigations and investigations could adversely affect our financial condition or results of operations.

From time to time, the Company is a party to litigation and other contingencies, including examinations by taxing authorities, which arise in the ordinary course of business. The Company believes that the resolution of such litigation and other contingencies will not materially harm its business, financial condition or results of operations.

Warranty Reserve. The following tables summarize the warranty reserve balance:

Balance as of September 30, 2006	Additions to Accrual	Accrual Utilized	Balance as of March 31, 2007
	(in thousands)		
$ 16,442	$ 9,315	$ (9,551)	$ 16,206

Balance as of October 1, 2005	Additions to Accrual	Accrual Utilized	Balance as of April 1, 2006
	(in thousands)		
$ 20,867	$ 7,199	$ (6,706)	$ 21,360

Note 11. Restructuring Costs

Costs associated with restructuring activities initiated on or after January 1, 2003, other than those activities related to purchase business combinations, are accounted for in accordance with SFAS No. 146 and SFAS No. 112 where applicable. Pursuant to SFAS No. 112, restructuring costs related to employee severance are recorded when probable and estimable. For all other restructuring costs, a liability is recognized in accordance with SFAS No. 146 only when incurred. Costs associated with restructuring activities initiated prior to January 1, 2003, other than those activities related to purchase business combinations, are accounted for in accordance with EITF 94-3 and SFAS No. 112 where applicable. Accordingly, costs associated with such plans are recorded as restructuring costs in the Consolidated Statements of Operations generally at the commitment date. Costs associated with restructuring activities related to purchase business combinations are accounted for in accordance with EITF 95-3. Accrued restructuring costs are included in accrued liabilities in the Condensed Consolidated Balance Sheets.

In November 2006, the Company announced three new restructuring initiatives:

- The realignment of its original design manufacturing activities to focus on joint development;
- The separation of its personal and business computing business and the evaluation of strategic alternatives to enhance its value: and
- Other consolidation and facility closure actions.

Below is a summary of the activities related to restructuring initiated in the three and six months ended March 31, 2007:

	Employee Termination / Severance and Related Benefits (In thousands) Cash	**Leases and Facilities Shutdown and Consolidation Costs Cash**	**Impairment of Fixed Assets or Redundant Fixed Assets Non-Cash**	**Total**
Balance at September 30, 2006	$	$	$	$
Charges to operations	501	364		865
Charges utilized	(501)	(364)		(865)
Balance at December 30, 2006				
Charges to operations	17,876	55		17,931
Charges utilized	(1,833)	(55)		(1,888)
Balance at March 31, 2007	$ 16,043	$	$	$ 16,043

During the three months and six months ended March 31, 2007, the Company recorded restructuring charges of approximately $17.9 million and $18.8 million, respectively. The majority of these charges were for employee termination benefits for approximately 900 employees primarily in two of the Company s European facilities. Approximately $2.3 million of employee termination benefits were utilized and approximately 300 employees were terminated during the six month period ended March 31, 2007.

Below is a summary of the activities related to restructuring activities that were announced in prior fiscal years:

	Employee Termination / Severance and Related Benefits (In thousands) Cash	**Leases and Facilities Shutdown and Consolidation Costs Cash**	**Impairment of Fixed Assets or Redundant Fixed Assets Non-Cash**	**Total**
Balance at October 2, 2004	$ 18,807	$ 18,732	$	$ 37,539
Charges to operations	86,736	22,996	11,039	120,771
Charges utilized	(68,606)	(27,262)	(11,039)	(106,907)
Reversal of accrual	(2,508)			(2,508)
Balance at October 1, 2005	34,429	14,466		48,895
Charges to operations	97,226	16,964	24,029	138,219
Charges utilized	(97,323)	(21,166)	(24,029)	(142,518)
Reversal of accrual	(5,528)	(460)		(5,988)
Balance at September 30, 2006	28,804	9,804		38,608
Charges to operations	2,370	3,120	(2,874)	2,616
Charges utilized	(16,949)	(3,954)	2,874	(18,029)
Reversal of accrual	(266)			(266)
Balance at December 30, 2006	13,959	8,970		22,929
Charges to operations	483	1,744	(879)	1,348
Charges utilized	(1,422)	(2,709)	879	(3,252)
Reversal of accrual	(243)	(89)		(332)
Balance at March 31, 2007	$ 12,777	$ 7,916	$	$ 20,693

During the three month period ended March 31, 2007, the Company recognized a net gain of approximately $879,000 from the sale of facilities that had previously been exited. The employee termination benefits were related to involuntary termination of employees, the majority of which were involved in manufacturing activities. Approximately $1.4 million of employee termination benefits were utilized and approximately 1,000 employees were terminated during the three month period ended March 31, 2007.

During the six month period ended March 31, 2007, the Company recognized a net gain of approximately $3.8 million from the sale of facilities that had previously been exited. The employee termination benefits were related to

involuntary termination of employees, the majority of which were involved in manufacturing activities. Approximately $18.4 million of employee termination benefits were utilized and approximately 4,000 employees were terminated during the six month period ended March 31, 2007.

As of March 31, 2007, the Company s accrued estimate of the lease loss related to all restructuring activities that were announced in prior fiscal years was approximately $7.9 million. The Company expects to pay remaining facilities related restructuring liabilities for all restructuring plans announced in prior fiscal years through 2010. Total restructuring costs accrued as of March 31, 2007 were $36.7 million, of which $35.8 million was included in accrued liabilities and $0.9 million was included in other long-term liabilities on the Condensed Consolidated Balance Sheet.

Segments. The following table summarizes the net restructuring costs incurred with respect to the Company s reportable segments (in thousands):

	Three Months ended March 31, 2007 (In thousands)	Six Months ended March 31, 2007
Personal Computing	$ 1,855	$ (141)
Standard Electronic Manufacturing Services	17,092	22,303
Total	$ 18,947	$ 22,162
Cash	$ 19,826	$ 25,915
Non-cash	(879)	(3,753)
Total	$ 18,947	$ 22,162

The cumulative restructuring costs per segment have not been disclosed as it is impractical to do so. The recognition of restructuring charges requires the Company s management to make judgments and estimates regarding the nature, timing, and amount of costs associated with the planned exit activity, including estimating sublease income and the fair value, less selling costs, of property, plant and equipment to be disposed of. Management s estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities already recorded.

Note 12. Business Segment, Geographic and Customer Information

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information , establishes standards for reporting information about operating segments, products and services, geographic areas of operations and major customers. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker or decision making group in deciding how to allocate resources and in assessing performance.

The following table presents information about reportable segments for the following periods:

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(In thousands)			
Net sales:				
Electronic Manufacturing Services	$ 1,805,060	$ 1,923,421	$ 3,746,793	$ 3,834,810
Personal Computing	806,629	744,997	1,643,686	1,695,405
Total net sales	$ 2,611,689	$ 2,668,418	$ 5,390,479	$ 5,530,215
Gross profit:				
Electronic Manufacturing Services	$ 122,359	$ 151,312	$ 275,615	$ 300,564
Personal Computing	15,361	13,247	30,783	32,482
Total gross profit	$ 137,720	$ 164,559	$ 306,398	$ 333,046

For the three months ended March 31, 2007, three customers in Personal Computing accounted for 11.7%, 11.3% and 11.0%, respectively, of total consolidated revenues. For the six months ended March 31, 2007 three customers in Personal Computing accounted for 12.3%, 10.7% and 10.7%, respectively, of consolidated revenue. For the quarters ended March 31, 2007 and April 1, 2006, there were no inter-segment sales between Standard Electronic Manufacturing Services and Personal Computing.

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The following summarizes financial information by geographic segment:

	Three Months Ended March 31, 2007	April 1, 2006	Six Months Ended March 31, 2007	April 1, 2006
	(In thousands)			
Net sales:				
Domestic	$ 627,029	$ 692,849	$ 1,332,771	$ 1,416,151
International	1,984,660	1,975,569	4,057,708	4,114,064
Total net sales	$ 2,611,689	$ 2,668,418	$ 5,390,479	$ 5,530,215

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(In thousands)			
Operating Income:				
Domestic	$ (6,477)	$ 8,387	$ 3,073	$ (8,148)
International	21,172	36,025	70,155	84,036
Total operating income	$ 14,695	$ 44,412	$ 73,228	$ 75,888

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

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to our expectations for future events and time periods. All statements other than statements of historical fact are statements that could be deemed to be forward-looking statements, including any statements regarding trends in future revenues or results of operations, gross margin or operating margin, expenses, earnings or losses from operations, synergies or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning developments, performance or industry ranking; any statements regarding future economic conditions or performance; any statements regarding pending investigations, claims or disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. Generally, the words anticipate, believe, plan, expect, future, intend, may, will, should, estimate, predict, potential, continue and similar expressions identify forward-looking statements. Our forward-looking statements are based on current expectations, forecasts and assumptions and are subject to risks, uncertainties and changes in condition, significance, value and effect. We undertake no obligation to publicly disclose any revisions to these forward-looking statements to reflect events or circumstances occurring subsequent to filing this report with the Securities and Exchange Commission.

Overview

We are a leading independent global provider of customized, integrated electronics manufacturing services, or EMS. Our revenue is generated from sales of our services primarily to original equipment manufacturers, or OEMs, in the communications, personal and business computing, enterprise computing and storage, multimedia, industrial and semiconductor capital equipment, defense and aerospace, medical and automotive industries.

A relatively small number of customers historically have been responsible for a significant portion of our net sales. Sales to our ten largest customers accounted for 62.5% and 61.8% of our net sales for the three and six months ended March 31, 2007, respectively. Three customers accounted for 10% or more of our net sales during both the three and six month periods ended March 31, 2007. Sales to our ten largest customers accounted for 60.9% and 62.5% of our net sales for the three and six months ended April 1, 2006, respectively, and two customers accounted for 10% or more of our net sales during those periods.

In recent periods, we have generated a significant portion of our net sales from international operations. During the six month periods ended March 31, 2007 and April 1, 2006, 75.3% and 74.4%, respectively, of our consolidated net sales were derived from non-U.S. operations. Consolidated net sales from international operations during the three month periods ended March 31, 2007 and April 1, 2006 represented 76.0% and 74.0%, respectively. The concentration of international operations has resulted from overseas acquisitions and a desire on the part of many of our customers to move production to lower cost locations in regions such as Asia, Latin America and Eastern Europe. We expect this trend to continue.

Historically, we have had substantial recurring sales from existing customers. We have also expanded our customer base through acquisitions. We typically enter into supply agreements with our major OEM customers. These agreements generally have terms ranging from three to five years and cover the manufacture of a range of products. Under these agreements, a customer typically agrees to purchase its requirements for particular products in particular geographic areas from us. These agreements generally do not obligate the customer to purchase minimum quantities of products. In some circumstances our supply agreements with customers provide for cost reduction objectives during the term of the agreement.

We have experienced fluctuations in gross margins and in our results of operations in the past and may continue to in the future. Fluctuations in our gross margins may be caused by a number of factors, including pricing, changes in product mix, competitive pressures, transition of manufacturing to lower cost locations and overall business levels.

On November 16, 2006, we announced three restructuring actions:

- The realignment of our original design manufacturing activities to focus on joint development;
- The separation of our personal and business computing business and the evaluation of strategic alternatives to enhance its value; and

- Other consolidation and facility closure actions.

Our expectation is that these initiatives will be concluded no later than the calendar year.

On March 19, 2007, we commenced a tender offer to exchange certain options to purchase shares of our common stock, whether vested or unvested, for new options that will be granted under our 1999 Stock Plan. The exchange ratio for this offer will range from one (1) to three (3) exchanged options for every one (1) new option granted. This tender offer will expire on May 15, 2007 unless extended and is subject to the terms and conditions set forth in the Offer to Exchange Certain Outstanding Options for New Options, dated March 19, 2007, which was filed with the Securities Exchange Commission on March 19, 2007. If all eligible options are exchanged, then 23,041,735 existing options will be cancelled and 19,137,035 new options will be granted. The purpose of this exchange is to mitigate the exposure with respect to Internal Revenue Code Section 409A. For more information, refer to our Tender Offer Statement filings with the Securities and Exchange Commission on April 13, 2007 and April 30, 2007.

Critical Accounting Policies and Estimates

Management s discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements which have been prepared in accordance with accounting principles generally accepted in the United States. We review the accounting policies used in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate the process used to develop estimates for certain reserves and contingent liabilities, including those related to product returns, accounts receivable, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates.

For a complete description of our key critical accounting policies and estimates, refer to our 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission on January 3, 2007.

Summary Results of Operations

The following table sets forth, for the three and six months ended March 31, 2007 and April 1, 2006, certain items in the Condensed Consolidated Statement of Operations expressed as a percentage of net sales. The table and the discussion below should be read in conjunction with the condensed consolidated financial statements and the notes thereto, which appear elsewhere in this report.

	Three Months Ended				**Six Months Ended**			
	March 31, 2007		**April 1, 2006 (Restated)**		**March 31, 2007**		**April 1, 2006 (Restated)**	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	94.7		93.8		94.3		94.0	
Gross margin	5.3		6.2		5.7		6.0	
Operating expenses:								
Selling, general and administrative	3.6		3.3		3.5		3.2	
Research and development	0.3		0.4		0.3		0.4	
Amortization of intangible assets	0.1		0.1		0.1		0.1	
Restructuring costs	0.7		0.7		0.4		0.9	
Total operating expenses	4.7		4.5		4.3		4.6	
Operating income	0.6		1.7		1.4		1.4	
Interest income	0.3		0.2		0.4		0.2	
Interest expense	(1.8	)	(1.2	)	(1.7	)	(1.2	)
Loss on extinguishment of debt			(3.2	)			(1.5	)
Other expense, net			(0.1	)	0.2		(0.2	)
Interest and other expense, net	(1.5	)	(4.3	)	(1.1	)	(2.7	)
Income (loss) before income taxes and cumulative effect of accounting changes	(0.9	)	(2.6	)	0.3		(1.3	)
Provision for (benefit from) income taxes	0.1		0.3		0.3		(0.1	)
Income (loss) before cumulative effect of accounting change	(1.0	)	(2.9	)	0.0		(1.2	)
Cumulative effect of accounting change, net of tax							0.1	
Net income (loss)	(1.0	)%	(2.9	)%	0.0	%	(1.1	)%

The following table sets forth, for the periods indicated, key operating results (in thousands):

	Three Months Ended March 31, 2007	April 1, 2006 (Restated)	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(In thousands)			
Net sales	$ 2,611,689	$ 2,668,418	$ 5,390,479	$ 5,530,215
Gross profit	$ 137,720	$ 164,559	$ 306,398	$ 333,046
Operating income	$ 14,695	$ 44,412	$ 73,228	$ 75,888
Net income (loss)	$ (26,132)	$ (76,062)	$ 2,117	$ (58,668)

Other key performance measures

The following table sets forth, for the periods indicated, certain key performance measures that management utilizes to assess operating results:

	Three Months Ended March 31, 2007	December 30, 2006	April 1, 2006
Days sales outstanding(1)	49	50	48
Inventory turns(2)	8.1	7.9	8.6
Accounts payable days(3)	51	52	51
Cash cycle days(4)	43	45	40

(1) Days sales outstanding is calculated as the ratio of ending accounts receivable, net, for the quarter divided by average daily net sales for the quarter.

(2) Inventory turns are calculated as the ratio of four times our cost of sales for the quarter divided by inventory at period end.

(3) Accounts payable days is calculated as the ratio of 365 days divided by accounts payable turns, in which accounts payable turns is calculated as the ratio of four times our cost of sales for the quarter divided by accounts payable at period end.

(4) Cash cycle days is calculated as the ratio of 365 days divided by inventory turns plus days sales outstanding minus accounts payable days.

Results of Operations

Net Sales

Net sales for the three month period ended March 31, 2007 decreased by 2.1% to $2.6 billion from $2.7 billion in the three month period ended April 1, 2006. Net sales decreased by 2.5% to $5.4 billion for the six months ended March 31, 2007, from $5.5 billion for the six months ended April 1, 2006. The decrease in sales for the three months ended March 31, 2007 was primarily due to decreased demand of approximately $97 million from our customers in the communications end-market and $77 million from the high-end computing end market partially offset by increases of $51 million from our personal computing end market, $31 million from our medical end market, and $16 million from our industrial instruments business. The decline in revenue for the six months ended March 31, 2007 was primarily due to decreased demand of approximately $139 million from our customers in the communications end-market and $131 million from our high-end computing end market partially offset by increases of $55 million from our medical end market, $49 million from our industrial instruments business and $48 million from our consumer product businesses.

Gross Margin

Gross margin decreased from 6.2% in the second quarter of fiscal 2006 to 5.3% in the second quarter of fiscal 2007 and decreased from 6.0% for the six months ended April 1, 2006 to 5.7% for the six months ended March 31, 2007. The decrease in gross margins for the three and six months ended March 31, 2007 was primarily attributable to unfavorable product mix as a result of weak demand in our communications and high end computing end-markets that

significantly impacted sales in our printed circuit board fabrication and new product introduction and high volume EMS operations. Lower demand in these higher margin businesses had a larger than proportional impact on our profitability. We expect gross margins to continue to fluctuate based on overall production and shipment volumes as well as changes in the mix of products demanded by our major customers.

Fluctuations in our gross margins may be caused by a number of factors, including:

- Greater competition in the EMS and pricing pressures from OEMs due to the greater cost reduction focus of global OEMs;
- Changes in the overall volume of our business;
- Changes in the mix of high and low margin products demanded by our customers;
- Changes in customer demand and sales volumes, including demand for our vertically integrated key system components and subassemblies;
- Charges or write offs of excess and obsolete inventory that we are not able to charge back to a customer or sales of inventories previously written down;
- Pricing pressure on electronic components resulting from economic conditions in the electronics industry, with EMS companies competing more aggressively on cost to obtain new or maintain existing business; and
- Our ability to transition manufacturing and assembly operations to lower cost regions in an efficient manner.

We have experienced fluctuations in gross margin in the past and may continue to do so in the future.

Operating Expenses

Selling, general and administrative expenses

Selling, general and administrative expenses increased $6.4 million to $93.5 million in the second quarter of fiscal 2007 from $87.1 million in the second quarter of fiscal 2006. Selling, general and administrative expenses increased as a percentage of net sales to 3.6% in the second quarter of fiscal 2007 from 3.3% in the second quarter of fiscal 2006. For the six months ended March 31, 2007, selling, general and administrative expenses increased to $189.8 million from $177.2 million for the six months ended April 1, 2006. Selling, general and administrative expenses increased as a percentage of net sales from 3.2% for the first six months of fiscal 2006 to 3.5% for the first six months of fiscal 2007. The dollar increase in selling, general and administrative expenses in the second quarter of fiscal 2007 as compared to the second quarter of fiscal 2006 was primarily attributable to an increase in stock based compensation expenses of $3.3 million and additional expenses we incurred in connection with our investigation of stock option administration policies and procedures of $1.2 million. The dollar increase in selling, general and administrative expenses for the six months ended March 31, 2007 as compared to the six months ended April 1, 2006 was primarily attributable to expenses we incurred in connection with our investigation of stock option administration policies and procedures of $5.5 million, increased selling and marketing expenses of $3.0 million, an increase in administration fees of $2.5 million related to an increase in the amount of accounts receivable sold during the first six months of fiscal 2007, an increase in the bad debt provision of $1.5 million, and an increase in stock based compensation expenses of $1.0 million. The increase in selling, general and administrative expenses for the three and six months ended March 31, 2007 as compared to the three and six months ended April 1, 2006 in terms of percentage of sales was primarily attributable to increased expenses as noted above and lower net sales for the three and six months ended March 31, 2007.

Research and Development

Research and development expenses decreased by $1.4 million to $9.0 million in the second quarter of fiscal 2007 from $10.4 million in the second quarter of fiscal 2006. Research and development expenses decreased by $1.6 million to $17.9 million for the six month period ended March 31, 2007 from $19.5 million for the six month period ended April 1, 2006. Research and development as a percentage of net sales decreased to 0.3% for both the three and six months ended March 31, 2007 from 0.4% for both the three and six months ended April 1, 2006.

Restructuring costs

We continually evaluate our business and operational structure including the location of our operations. Over the past few years, we have restructured our company in response to or in anticipation of changing business dynamics such as overall demand in the electronics industry as well as the movement of manufacturing operations from high cost regions to lower cost regions. These dynamics continue.

In November 2006, we announced three new restructuring initiatives:

- The realignment of our original design manufacturing activities to focus on joint development;
- The separation of our personal and business computing business and the evaluation of strategic alternatives to enhance our value: and
- Other consolidation and facility closure actions.

Costs associated with restructuring activities initiated on or after January 1, 2003, other than those activities related to purchase business combinations, are accounted for in accordance with SFAS No. 146 and SFAS No. 112 where applicable. Pursuant to SFAS No. 112, restructuring costs related to employee severance are recorded when probable and estimable. For all other restructuring costs, a liability is recognized in accordance with SFAS No. 146 only when incurred. Costs associated with restructuring activities initiated prior to January 1, 2003, other than those activities related to purchase business combinations, are accounted for in accordance with EITF 94-3 and SFAS No. 112 where applicable. Accordingly, costs associated with such plans are recorded as restructuring costs in the Consolidated Statements of Operations generally at the commitment date. Costs associated with restructuring activities related to purchase business combinations are accounted for in accordance with EITF 95-3. Accrued restructuring costs are included in accrued liabilities in the Condensed Consolidated Balance Sheets.

Below is a summary of the activities related to restructuring initiated in the three and six months ended March 31, 2007:

	Employee Termination / Severance and Related Benefits (In thousands)	**Leases and Facilities Shutdown and Consolidation Costs**	**Impairment of Fixed Assets or Redundant Fixed Assets**	
	Cash	**Cash**	**Non-Cash**	**Total**
Balance at September 30, 2006	$	$	$	$
Charges to operations	501	364		865
Charges utilized	(501)	(364)		(865)
Balance at December 30, 2006				
Charges to operations	17,876	55		17,931
Charges utilized	(1,833)	(55)		(1,888)
Balance at March 31, 2007	$ 16,043	$	$	$ 16,043

During the three months and six months ended March 31, 2007,we recorded restructuring charges of approximately $17.9 million and $18.8 million, respectively. The majority of these charges were for employee termination benefits for approximately 900 employees primarily in two of our European facilities. Approximately $2.3 million of employee termination benefits were utilized and approximately 300 employees were terminated during the six month period ended March 31, 2007.

Below is a summary of the activities related to restructuring activities that were announced in prior fiscal years:

	Employee Termination / Severance and Related Benefits (In thousands) Cash	Leases and Facilities Shutdown and Consolidation Costs Cash	Impairment of Fixed Assets or Redundant Fixed Assets Non-Cash	Total
Balance at October 2, 2004	$ 18,807	$ 18,732	$	$ 37,539
Charges to operations	86,736	22,996	11,039	120,771
Charges utilized	(68,606)	(27,262)	(11,039)	(106,907)
Reversal of accrual	(2,508)			(2,508)
Balance at October 1, 2005	34,429	14,466		48,895
Charges to operations	97,226	16,964	24,029	138,219
Charges utilized	(97,323)	(21,166)	(24,029)	(142,518)
Reversal of accrual	(5,528)	(460)		(5,988)
Balance at September 30, 2006	28,804	9,804		38,608
Charges to operations	2,370	3,120	(2,874)	2,616
Charges utilized	(16,949)	(3,954)	2,874	(18,029)
Reversal of accrual	(266)			(266)
Balance at December 30, 2006	13,959	8,970		22,929
Charges to operations	483	1,744	(879)	1,348
Charges utilized	(1,422)	(2,709)	879	(3,252)
Reversal of accrual	(243)	(89)		(332)
Balance at March 31, 2007	$ 12,777	$ 7,916	$	$ 20,693

During the three month period ended March 31, 2007, we recognized a net gain of approximately $879,000 from the sale of facilities that had previously been exited. The employee termination benefits were related to involuntary termination of employees, the majority of which were involved in manufacturing activities. Approximately $1.4 million of employee termination benefits were utilized and approximately 1,000 employees were terminated during the three month period ended March 31, 2007.

During the six month period ended March 31, 2007, we recognized a net gain of approximately $3.8 million from the sale of facilities that had previously been exited. The employee termination benefits were related to involuntary termination of employees, the majority of which were involved in manufacturing activities. Approximately $18.4 million of employee termination benefits were utilized and approximately 4,000 employees were terminated during the six month period ended March 31, 2007.

As of March 31, 2007, our accrued estimate of the lease loss related to all restructuring activities that were announced in prior fiscal years was approximately $7.9 million. We expect to pay remaining facilities related restructuring liabilities for all restructuring plans announced in prior fiscal years through 2010. Total restructuring costs accrued as of March 31, 2007 were $36.7 million, of which $35.8 million was included in accrued liabilities and $0.9 million was included in other long-term liabilities on the Condensed Consolidated Balance Sheet.

Segments. The following table summarizes the net restructuring costs incurred with respect to our reportable segments (in thousands):

	Three Months ended March 31, 2007 (In thousands)	Six Months ended March 31, 2007
Personal Computing	$ 1,855	$ (141)
Standard Electronic Manufacturing Services	17,092	22,303
Total	$ 18,947	22,162
Cash	$ 19,826	$ 25,915
Non-cash	(879)	(3,753)
Total	$ 18,947	$ 22,162

The cumulative restructuring costs per segment have not been disclosed as it is impractical to do so. The recognition of restructuring charges requires our management to make judgments and estimates regarding the nature, timing, and amount of costs associated with the planned exit activity, including estimating sublease income and the fair value, less selling costs, of property, plant and equipment to be disposed of. Management s estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities already recorded.

On November 16, 2006, we announced two strategic decisions: to realign our ODM activities to focus on joint development manufacturing and to create a more separable personal and business computing business unit. We also announced that we may further consolidate operations in higher-cost geographies to further enhance profitability. We expect to record additional charges that are currently not estimable related to these anticipated actions in fiscal year 2007.

Interest Expense

Interest expense increased $15.1 million to $45.8 million in the second quarter of fiscal 2007 from $30.7 million in the second quarter of fiscal 2006. Interest expense increased $25.4 million to $89.1 million for the six months ended March 31, 2007 from $63.7 million for the six months ended April 1, 2006. The increase in interest expense for the three and six months ended March 31, 2007 is primarily attributable to the interest expense related to the $600 million unsecured term loan we entered into and simultaneously drew down on October 13, 2006, higher interest rate due to the interest rate swap on our 6.75% Notes and interest expense from increased borrowing against our revolving credit facility during the first six months of fiscal 2007, partially offset by a decrease in interest expense from the refinancing of the 10.375% Notes with the 8.125% Notes during the second quarter of fiscal 2006.

Loss on Extinguishment of Debt (Restated)

On February 15, 2006, we issued $600 million aggregate principal amount of our 8.125% Notes. In connection with the debt issuance, we also made a cash tender offer for the redemption of all of our $750 million aggregate principal amount of our outstanding 10.375% Senior Subordinated Notes. The 10.375% Notes, which had been previously swapped to floating, cost us approximately $80 million in annual interest expense. In the process of evaluating our capital structure and other alternatives, we concluded, on a net present value basis, that our best economic strategy was to tender for the 10.375% Notes. The refinancing resulted in interest expense savings of approximately $31 million per year; was cash flow positive by approximately $21 million per year, net of forgone interest income on cash used; and was positive on a net present value basis over the long-term and extend our debt maturities, by way of issuance of the 8.125% Notes. The refinancing was also accretive to future earnings by approximately $0.05 per share per annum.

The 10.375% Notes were redeemed in full. As a result of the 10.375% Notes redemption, we recorded a loss on extinguishment of debt of approximately $84.6 million during the quarter ended April 1, 2006. The loss was comprised of $70.8 million of redemption premium, $2.2 million related to interest rate swap termination, $13.9 million in unamortized financing fees relating to the 10.375% Notes and $0.9 million of tender expenses offset by $3.2 million unamortized gain from previously terminated swaps. The tender offer was financed by net proceeds from the 8.125% Notes offering together with approximately $263.8 million of existing cash.

Other Income (Expense), net

Other expense, net was $0.6 million and $3.7 million for the three month periods ended March 31, 2007 and April 1, 2006, respectively. Other income (expense) net, was $10.4 million and $(9.4) million for the six month periods ended March

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31, 2007 and April 1, 2006, respectively. The following table summarizes the major components of other income (expense), net:

	Three Months Ended March 31, 2007	Three Months Ended April 1, 2006 (Restated)	Six Months Ended March 31, 2007	Six Months Ended April 1, 2006 (Restated)
	(In thousands)			
Foreign exchange gains (losses)	$ (684)	$ (1,970)	$ 2,168	$ (2,359)
Interest rate swap		(2,265)		(9,026)
Other, net	131	553	8,240	1,996
Other income (expense), net	$ (553)	$ (3,682)	$ 10,408	$ (9,389)

The decrease in other expense, net for the three month period ended March 31, 2007, is primarily attributable to the elimination of the interest rate swap related to the redemption of the 10.375% Notes during the second quarter of fiscal 2006 and the effectiveness of hedging of our foreign currency exposures.

The increase in other income (expense), net from an expense of $9.4 million in the six months ended April 1, 2006 to an income of $10.4 million in the six months ended March 31, 2007 is primarily attributable to the elimination of the interest rate swap related to the redemption of the 10.375% Notes during the second quarter of fiscal 2006, a $6.0 million gain from the sale of a manufacturing facility previously classified as assets held for sale and a $1.8 million gain related to the collection of previously fully reserved notes receivable. Additionally, for the six months ended March 31, 2007, foreign exchange gains included a $1.4 million gain related to the realization of currency translation adjustments related to the substantial liquidation of one of our foreign subsidiaries.

Provision for Income Taxes

Our effective tax rate for the three and six months ended March 31, 2007 was approximately (13.8%) and 85.0%, respectively, mainly due to forecasted losses in the U.S. and other certain foreign jurisdictions for which we record a full valuation allowance on future tax benefits.

Our effective tax rate for the three and six months ended April 1, 2006 was approximately (9.4%) and 9.0%, respectively, which was net of a $27.9 million tax benefit resulting from a favorable settlement with the U.S. Internal Revenue Service in relation to certain U.S. tax audits.

Liquidity and Capital Resources

	Six Months Ended March 31, 2007	April 1, 2006 (Restated)
	(Unaudited) (In thousands)	
Net cash provided by (used in):		
Continuing operations		
Operating activities	$ 124,024	$ (155,433)
Investing activities	(14,001)	(51,026)
Financing activities	68,687	(230,771)
Effect of exchange rate changes	(6,447)	(5,617)
Increase (decrease) in cash and cash equivalents	$ 172,263	$ (442,847)

Cash and cash equivalents were $677.3 million at March 31, 2007 and $505.6 million at September 30, 2006, including restricted cash of $13.2 million and $13.8 million at March 31, 2007 and September 30, 2006, respectively.

Net cash provided by (used in) operating activities was $124.0 million and $(155.4) million for the six months ended March 31, 2007 and April 1, 2006, respectively. Net cash provided by operating activities for the six months ended March 31, 2007 was primarily due to a decrease in accounts receivable, net of proceeds from the sale of accounts receivable, and inventory, partially offset by a decrease in accounts payable and accrued liabilities due to payments made to vendors. Working capital was $1.0 billion and $1.5 billion as of March 31, 2007 and September 30, 2006, respectively. We continue to focus on improving cash cycle days and working capital and expect to generate positive cash flow throughout the remainder of the fiscal year.

Net cash used in investing activities was $14.0 million and $51.0 million for the six months ended March 31, 2007 and April 1, 2006, respectively. Net cash used in investing activities for the six months ended March 31, 2007 was primarily due to $40.4 million in purchases of additional property, plant and equipment and payments of $4.2 million for business acquired partially offset by $30.8 million in proceeds from the sale of property, plant and equipment during the period. We continue to actively market certain surplus real estate and are considering potential divestures which we expect will generate positive cash flow throughout the remainder of the fiscal year.

Net cash provided by (used in) financing activities was $68.7 million and $(230.8) million for the six months ended March 31, 2007 and April 1, 2006, respectively. Net cash provided by financing activities for the six months ended March 31, 2007 was primarily related to the issuance of the $600 million Senior Unsecured Term Loan offset by the repayment of $525 million related to the 3% Notes (see below) which were due on March 15, 2007. The Senior Unsecured Term Loan matures on January 31, 2008. We intend to fund the repayment of the Senior Unsecured Term Loan through cash flow from operations, improvements in working capital, sales of real estate, divestitures of certain businesses or other financing alternatives.

Senior Unsecured Term Loan. On October 13, 2006, we entered into a Credit and Guaranty Agreement (the Term Loan Agreement) providing for a $600.0 million senior unsecured term loan which matures on January 31, 2008. We drew down the $600.0 million term loan simultaneously with the closing of the transaction.

The loan bears interest at our election at either the prime rate plus 1.5% or at an adjusted LIBOR rate plus 2.5%. On the 181st day after closing, the interest rate margins with respect to all loans will increase by 0.5% for the remaining life of the loans. Interest is payable quarterly in arrears with respect to prime rate loans. For LIBOR rate loans, interest is payable at the end of each interest period depending on our election of the length of borrowing period (i.e. one month, three months or six months). Principal, together with accrued and unpaid interest, is due at maturity. In addition, we are required to make mandatory prepayments of principal with the net cash proceeds from the sale of certain assets and the incurrence of certain debt.

All of our existing and future domestic subsidiaries will guaranty the obligations under the Term Loan Agreement, subject to some limited exceptions.

The Term Loan Agreement contains affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, certain reporting requirements in accordance with the agreement and compliance with applicable laws and regulations. Further, the Term Loan Agreement contains negative covenants limiting our ability and our subsidiaries, among other things, to incur debt,

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grant liens and make certain restricted payments. The events of default under the Term Loan Agreement include payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events.

As of March 31, 2007 and September 30, 2006, we had no other term loans.

8.125% Senior Subordinated Notes. On February 15, 2006, we issued $600 million aggregate principal amount of 8.125% Senior Subordinated Notes due 2016 (the 8.125% Notes). Interest is payable on the 8.125% Notes on March 1 and September 1 of each year beginning on September 1, 2006. The maturity date of the 8.125% Notes is March 1, 2016. Debt issuance costs are included in prepaid expenses and other current assets and other non-current assets and amortized on a straight-line basis over the life of the debt as interest expense. As of March 31, 2007, $1.9 million is included in prepaid expenses and other current assets and $15.3 million is included in other non-current assets. The difference between the amount of amortization calculated using the straight-line method as compared to the effective interest method was immaterial. The 8.125% Notes are unsecured and subordinated in right of payment to all of our existing and future senior debt, as defined in the indenture under which the 8.125% Notes were issued.

We may redeem the 8.125% Notes, in whole or in part, at any time prior to March 1, 2011, at a redemption price that is equal to the sum of (1) the principal amount of the 8.125% Notes to be redeemed, (2) accrued and unpaid interest on those 8.125% Notes to, but excluding, the redemption date and (3) a make-whole premium calculated in the manner specified in the Indenture for the 8.125% Notes. We may redeem the 8.125% Notes, in whole or in part, beginning on March 1, 2011, at declining redemption prices ranging from 104.063% to 100% of the principal amount of the 8.125% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, with the actual redemption price to be determined based on the date of redemption. At any time prior to March 1, 2009, we may redeem up to 35% of the 8.125% Notes with the proceeds of certain equity offerings at a redemption price equal to 108.125% of the principal amount of the 8.125% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, so long as after giving effect to any such redemption, at least 65% of the aggregate principal amount of the 8.125% Notes remains outstanding.

Following a change of control, as defined in the Indenture, we will be required to make an offer to repurchase all or any portion of the 8.125% Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest to, but excluding, the date of repurchase.

The 8.125% Notes Indenture includes covenants that limit our ability and our restricted subsidiaries to, among other things: incur additional debt, make investments and other restricted payments, pay dividends on capital stock, or redeem or repurchase capital stock or subordinated obligations; create specified liens; sell assets; create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to us; engage in transactions with affiliates; incur layered debt; and consolidate or merge with or into other companies or sell all or substantially all of our assets. The restrictive covenants are subject to a number of important exceptions and qualifications set forth in the Indenture for the 8.125% Notes.

The 8.125% Notes Indenture provides for customary events of default, including:

- payment defaults;
- breaches of covenants;
- certain payment defaults at final maturity or acceleration of certain other indebtedness;
- failure to pay certain judgments;
- certain events of bankruptcy, insolvency and reorganization; and
- certain instances in which a guarantee ceases to be in full force and effect.

If any event of default occurs and is continuing, subject to certain exceptions, the trustee or the holders of at least 25% in aggregate principal amount of the then outstanding 8.125% Notes may declare all the 8.125% Notes to be due and payable immediately, together with any accrued and unpaid interest, if any, to the acceleration date. In the case of an event of default resulting from certain events of bankruptcy, insolvency or reorganization, such amounts with respect to the 8.125% Notes will be due and payable immediately without any declaration or other act on the part of the trustee or the holders of the 8.125% Notes.

On January 3, 2007, the Company and U.S. Bank National Association, as trustee, entered into a supplemental indenture to the indenture under which the Company s 8.125% Senior Subordinated Notes due 2016 were issued. As permitted by the indenture, the supplemental indenture released each of the note s guarantors from its respective obligations under its notes guarantee and the indenture.

6.75% Senior Subordinated Notes. On February 24, 2005, we issued $400 million aggregate principal amount of our 6.75% Senior Subordinated Notes due 2013 (the 6.75% Notes). Interest is payable on the 6.75% Notes on March 1 and September 1 of each year, beginning on September 1, 2005. The maturity date of the 6.75% Notes is March 1, 2013. In June 2005, we completed an exchange offer pursuant to which substantially all of the 6.75% Notes were exchanged for notes registered under the Securities Act of 1933. These notes evidence the same debt as the original 6.75% Notes and are issued and entitled to the benefits of the same indenture that governs the original the 6.75% Notes except that they are not subject to transfer restrictions.

The 6.75% Notes are unsecured and subordinated in right of payment to all of our existing and future senior debt as defined in the 6.75% Notes Indenture. We may redeem the 6.75% Notes, in whole or in part, at any time prior to March 1, 2009, at a redemption price that is equal to the sum of (1) the principal amount of the 6.75% Notes to be redeemed, (2) accrued and unpaid interest to, but excluding, the redemption date on those 6.75% Notes and (3) a make-whole premium calculated in the manner specified in the 6.75% Notes Indenture. We may redeem the 6.75% Notes, in whole or in part, beginning on March 1, 2009, at declining redemption prices ranging from 103.375% to 100% of the principal amount, plus accrued and unpaid interest to, but excluding, the redemption date, with the actual redemption price to be determined based on the date of redemption. At any time prior to March 1, 2008, we may redeem up to 35% of the 6.75% Notes with the proceeds of certain equity offerings at a redemption price equal to 106.75% of the principal amount of the 6.75% Notes, plus accrued and unpaid interest to, but excluding, the redemption date, so long as after giving effect to any such redemption, at least 65% of the aggregate principal amount of the 6.75% Notes remains outstanding.

Following a change of control, as defined in the 6.75% Notes Indenture, we will be required to make an offer to repurchase all or any portion of the 6.75% Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest to, but excluding, the date of repurchase.

The 6.75% Notes Indenture includes covenants that limit our ability and the ability of our restricted subsidiaries to, among other things: incur additional debt, make investments and other restricted payments, pay dividends on capital stock, or redeem or repurchase capital stock or subordinated obligations; create specified liens; sell assets; create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to us; engage in transactions with affiliates; incur layered debt; and consolidate or merge with or into other companies or sell all or substantially all of our assets. The restricted covenants are subject to a number of important exceptions and qualifications set forth in the 6.75% Notes Indenture.

The 6.75% Notes Indenture provides for customary events of default, including payment defaults, breaches of covenants, certain payment defaults at final maturity or acceleration of certain other indebtedness, failure to pay certain judgments, certain events of bankruptcy, insolvency and reorganization and certain instances in which a guarantee ceases to be in full force and effect. If any event of default occurs and is continuing, subject to certain exceptions, the trustee or the holders of at least 25% in aggregate principal amount of the then outstanding 6.75% Notes may declare all the 6.75% Notes to be due and payable immediately, together with any accrued and unpaid interest, if any, to the acceleration date. In the case of an event of default resulting from certain events of bankruptcy, insolvency or reorganization, such amounts with respect to the 6.75% Notes will be due and payable immediately without any declaration or other act on the part of the trustee or the holders of the 6.75% Notes.

On January 3, 2007, the Company and U.S. Bank National Association, as trustee, entered into a supplemental indenture to the indenture under which the Company s 6.75% Senior Subordinated Notes due 2013 were issued. As permitted by the indenture, the supplemental indenture released each of the note s guarantors from its respective obligations under its notes guarantee and the indenture.

3% Convertible Subordinated Notes due 2007. In March 2000, SCI issued $575.0 million aggregate principal amount of 3% Convertible Subordinated Notes due March 15, 2007, or 3% Notes. On October 13, 2006, SCI Systems, Inc., one of the Company s wholly-owned subsidiaries (SCI Systems), initiated, in accordance with the terms thereof, the satisfaction and discharge of the Indenture, dated as of March 15, 2000, by and between SCI Systems and the Bank of New York Trust Company, National Association, as trustee (as supplemented, the Indenture), pursuant to which SCI Systems issued its 3% Notes due 2007. As a result, $532.9 million in cash was deposited with the trustee which represented a portion of the proceeds obtained from the Senior Unsecured Term Loan entered into on October 13, 2006 and is equal to the principal and interest due on the 3% Notes at maturity on March 15, 2007. The $532.9 million was recorded as restricted cash and classified in the Condensed Consolidated Financial Statements as a current asset as of December 30, 2006. The restricted

cash of $532.9 million was released by the trustee to pay the bondholders upon maturity of the 3% Notes on March 15, 2007. Accordingly, as of March 31, 2007, the 3% Notes were fully satisfied and discharged.

Senior Credit Facility. On October 26, 2004, we entered into a Credit and Guaranty Agreement (the Original Credit Agreement) providing for a $500 million senior secured revolving credit facility with a $150 million letter of credit sub-limit. The senior secured credit facility provided for a maturity date of October 26, 2007. We entered into an Amended and Restated Credit and Guaranty Agreement, dated as of December 16, 2005, among us, certain of our subsidiaries, as guarantors, and the lenders that are parties thereto from time to time (the Restated Credit Agreement). The Restated Credit Agreement amended and restated the Original Credit Agreement among other things, to:

- extend the maturity date from October 26, 2007 to December 16, 2008;
- amend the leverage ratio;
- permit us and the guarantors to sell domestic receivables pursuant to factoring or similar arrangements if certain conditions are met; and
- revise the collateral release provisions.

All of our existing and future domestic subsidiaries guaranty the obligations under the Restated Credit Agreement, subject to some limited exceptions. Our obligations and the obligations of our subsidiaries under the credit facility are secured by: substantially all of our assets; substantially all of the assets of substantially all of our United States subsidiaries located in the United States; a pledge of all capital stock of substantially all of our United States subsidiaries; a pledge of 65% of the capital stock of certain of our and our United States subsidiaries first-tier foreign subsidiaries; and mortgages on certain domestic real estate.

The Restated Credit Agreement requires us to comply with a fixed charge coverage ratio and a ratio of total debt to earnings before income tax, depreciation and amortization (EBITDA). Additionally, the credit facility contains numerous affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, reporting requirements and compliance with applicable laws and regulations. Further, the credit facility contains negative covenants limiting the ability of us and our subsidiaries, among other things, to incur debt, grant liens, make acquisitions, make certain restricted payments, sell assets and enter into sale and lease back transactions. The events of default under the credit facility include payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events.

At any time the aggregate face amount of receivables sold by us and the guarantors together with any outstanding amounts exceeds the thresholds set forth in the Restated Credit Agreement, the revolving credit commitments for purposes of making loans and issuing letters of credit will be zero.

On October 13, 2006, we and the required lenders entered into an amendment for its Restated Credit Agreement to permit us to enter into the Senior Unsecured Term Loan described above. The amendment also revised the collateral release provision under the Restated Credit Agreement such that collateral (other than stock pledges and other collateral we request not to be released) will be released at such time as specified conditions are met, including that we have repaid in full the outstanding amount under the Senior Unsecured Term Loan and our credit ratings meets specified thresholds. If following the release of any portion of the collateral pursuant to the provisions of the credit agreement described above, our credit ratings fall below specified thresholds, then we are required to take such actions as are necessary to grant and perfect a security interest in the assets and properties that would at that time comprise the collateral if the relevant collateral documents were still in effect. On December 29, 2006, we entered into an amendment and waiver to the Restated Credit Agreement. Among other things, this amendment amended the minimum required levels for both financial covenants and certain related definitions. The fees in regards to the amendment and waiver were deferred and amortized over the debt period. The amount of the fees was immaterial to the consolidated financial statements.

There was approximately $100 million of loans outstanding under the Restated Credit Agreement at an average interest rate of 7.58% as of March 31, 2007. Additionally, we pay a commitment fee of 0.35% on the unused portion of the credit facility.

We are in compliance with our covenants for the above debt instruments as of March 31, 2007. However, we may be required to seek waivers or amendments to certain covenants for the above debt instruments if we are unable to comply with the requirements of the covenants in the future or if we take actions such as the divestiture of strategic assets that are not permitted by the covenants.

Sale of Accounts Receivable. Certain of our subsidiaries have entered into agreements that permit them to sell specified accounts receivable. The purchase price for receivables sold under these agreements ranges from 95% to 100% of the face amount less a discount charge (based on LIBOR plus a percentage ranging from 0.4% to 1.5%) for the period from the date the receivable is sold to its collection date. Accounts receivable sales under these agreements were $498.5 million and $976.9 million for the three and six month periods ended March 31, 2007, respectively. The sold receivables are subject to certain limited recourse provisions. In accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liability, accounts receivable sold are removed from the Condensed Consolidated Balance Sheet and are reflected as cash provided by operating activities in the Condensed Consolidated Statement of Cash Flows. As of March 31, 2007, $320.5 million of sold accounts receivable remain subject to certain recourse provisions. We have not experienced any credit losses under these recourse provisions. The discount charge recorded during the period was not material to the Condensed Consolidated Financial Statements. The discount charge is recorded in selling, general and administrative expenses on the Condensed Consolidated Statement of Operations.

As part of the sale of accounts receivable, we had a retained ownership interest (i.e. 100% of the receivable face amount less the purchase price) of $10.3 million at March 31, 2007. The retained interest was included in prepaid and other current assets. The retained interest has subsequently been collected.

Our future needs for financial resources are largely dependent on increases in working capital to support anticipated sales growth, investments in manufacturing inventory, facilities and equipment, and repayments of obligations under outstanding indebtedness. Additionally, we anticipate incurring additional expenditures in connection with our restructuring activities in fiscal 2007.

We believe that our existing cash resources and other sources of liquidity, together with cash generated from operations, will be sufficient to meet our working capital requirements through at least the next 12 months. Should demand for our products decrease over the next 12 months, the available cash provided by operations could be negatively impacted. Other sources of liquidity include our available line of credit and sales of accounts receivable. We may also seek to raise additional capital through the issuance of either debt or equity securities. Our senior secured credit facility, the indentures governing our 8.125% Notes and our 6.75% Notes and our senior unsecured term loan include covenants that, among other things, limit in certain respects us and our restricted subsidiaries from incurring debt, making investments and other restricted payments, paying dividends on capital stock, redeeming capital stock or subordinated obligations and creating liens. We may be required to seek waivers or amendments to certain restrictive debt covenants in the future if we are unable to comply with these covenants or if we seek to take actions that are prohibited by these covenants such as the divestiture of strategic assets. We may not be able to obtain such waivers or amendments, and these covenants may impair our ability to conduct our business or carry out our restructuring plans. Further, we may be required to refinance our outstanding debt in the future, and we cannot assure you that we will be able to do so on acceptable terms or at all. In addition to existing collateral and covenant requirements, future debt financing may require us to pledge assets as collateral and comply with financial ratios and covenants. Equity financing may result in dilution to stockholders.

Risk Factors Affecting Operating Results

We are exposed to general market conditions in the electronics industry which could have a material adverse impact on our business, operating results and financial condition.

From time to time, many of our customers have experienced significant decreases in demand for their products and services. This volatility has resulted, and will continue from time to time to result, in our customers delaying purchases of the products we manufacture for them, and placing purchase orders for lower volumes of products than previously anticipated. In addition, the EMS industry has been experiencing an increase in excess manufacturing capacity as well as increased competition from Asian competitors. These factors will likely result in significant continued price competition among EMS companies, and this competition will likely continue to affect our results of operations. In addition, OEM customers are increasingly requiring us and other EMS companies to move production of their products to lower-cost locations and away from high cost locations such as the United States and Western Europe. As a result, we have had to close facilities in the United States and Europe and incur costs for facility closure, employee severance and related items. We may need to close additional facilities and incur related closure costs in future fiscal periods.

We cannot accurately predict future levels of demand for our customers electronics products. Consequently, our past operating results, earnings and cash flows may not be indicative of our future operating results, earnings and cash flows. In particular, if the economic recovery in the electronics industry does not demonstrate sustained momentum, and if price competition for EMS services continues to be intense, our operating results may be adversely affected.

If demand for our higher-end, higher margin manufacturing services does not improve, our future gross margins and operating results may be lower than expected.

Before the economic downturn in the communications sector and before our merger with SCI Systems, Inc., sales of our services to OEMs in the communications sector accounted for a substantially greater portion of our net sales and earnings than in recent periods. As a result of reduced sales to OEMs in the communications sector, our gross margins have declined because the services that we provided to these OEMs often were more complex, thereby generating higher margins, than those that we provided to OEMs in other sectors of the electronics industry. For example, a substantial portion of our net sales are currently derived from sales of personal computers. Margins on personal computers are typically lower than margins that we have historically realized on communication products. OEMs are continuing to seek price decreases from us and other EMS companies, and competition for this business remains intense. Pricing pressure is typically more intense for less complex, lower margin EMS services. Pricing pressure on EMS companies continues to be strong and there continues to be intense price competition for EMS services. This price competition has affected, and could continue to adversely affect, our gross margins. If demand for our higher-end, higher margin manufacturing services do not improve in the future, our gross margins and operating results in future periods may be adversely affected.

Our operating results are subject to significant uncertainties.

Our operating results are subject to significant uncertainties, including the following:

- economic conditions in the electronics industry;
- the timing of orders from major customers and the accuracy of their forecasts;
- the timing of expenditures in anticipation of increased sales, customer product delivery requirements and shortages of components or labor;
- the mix of products ordered by and shipped to major customers, as high volume and low complexity manufacturing services typically have lower gross margins than more complex and lower volume services;
- the degree to which we are able to utilize our available manufacturing capacity;
- our ability to effectively plan production and manage our inventory and fixed assets;
- customer insolvencies resulting in bad debt exposures that are in excess of our accounts receivable reserves;
- our ability to efficiently move manufacturing activities to lower cost regions without adversely affecting customer relationships and while controlling facilities closure and employee severance costs;
- pricing and other competitive pressures;
- seasonality in customers product requirements;
- fluctuations in component prices;
- political and economic developments in countries in which we have operations;

- component shortages, which could cause us to be unable to meet customer delivery schedules; and
- new product development by our customers.

A portion of our operating expenses is relatively fixed in nature, and planned expenditures are based in part on anticipated orders, which are difficult to estimate. If we do not receive anticipated orders as expected, our operating results will be adversely impacted. Moreover, our ability to reduce our costs as a result of current or future restructuring efforts may be limited because consolidation of operations can be costly and a lengthy process to complete.

Adverse changes in the key end markets we target could harm our business.

We provide EMS services for companies that sell products in the communications, computing and storage, multimedia, industrial and semiconductor systems, defense and aerospace, medical and automotive sectors of the electronics industry. Adverse changes in these markets can reduce demand for our customers   products and make these customers more price sensitive, either of which could adversely affect our business and results of operations. Factors affecting any of our customers   industries in general, or our customers in particular, could seriously harm our business. These factors include:

- rapid changes in technology or evolving industry standards and requirements for continuous improvement in products and services, result in short product life cycles;

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- demand for our customers products may be seasonal;

- our customers may fail to successfully market their products, and our customers products may fail to gain widespread commercial acceptance;

- our customers may experience dramatic market share shifts in demand which may cause them to exit the business; and

- there may be recessionary periods in our customers markets.

Future developments in end markets we serve, particularly in those markets which account for more significant portions of our revenues, could harm our business and our results of operations.

An adverse change in the interest rates for our borrowings could adversely affect our financial condition.

Interest to be paid by us on any borrowings under any of our credit facilities and other long-term debt obligations may be at interest rates that fluctuate based upon changes in various base interest rates. Recently, interest rates have trended upwards in major global financial markets. These interest rate trends have resulted in increases in the base rates upon which our interest rates are determined. Continued increases in interest rates could have a material adverse effect on our financial position, results of operations and cash flows, particularly if such increases are substantial. In addition, interest rate trends could affect global economic conditions.

We generally do not obtain long-term volume purchase commitments from customers and, therefore, cancellations, reductions in production quantities and delays in production by our customers could adversely affect our operating results.

We generally do not obtain firm, long-term purchase commitments from our customers. Customers may cancel their orders, reduce production quantities or delay production for a number of reasons. In the event our customers experience significant decreases in demand for their products and services, our customers may cancel orders, delay the delivery of some of the products that we manufacture or place purchase orders for fewer products than we previously anticipated. Even when our customers are contractually obligated to purchase products from us, we may be unable or, for other business reasons, choose not to enforce our contractual rights. Cancellations, reductions or delays of orders by customers would:

- adversely affect our operating results by reducing the volumes of products that we manufacture for our customers;
- delay or eliminate recoupment of our expenditures for inventory purchased in preparation for customer orders; and
- lower our asset utilization, which would result in lower gross margins.

In addition, customers may require that we transfer the manufacture of their products from one facility to another to achieve cost reductions and other objectives. These transfers may result in increased costs to us due to facility downtime or less than optimal utilization of our manufacturing capacity. These transfers may also require us to close or reduce operations at certain facilities, particularly those in high cost locations, and as a result we could incur increased costs for facilities closure, employee severance and related matters.

We rely on a small number of customers for a substantial portion of our net sales, and declines in sales to these customers could adversely affect our operating results.

Most of our sales come from a small number of customers. Sales to our ten largest customers accounted for 61.8% of our net sales during the first half of fiscal 2007 and sales to three customers each accounted for more than 10% of our net sales for that period. We depend on the continued growth, viability and financial stability of our customers, substantially all of which operate in an environment characterized by rapid technological change, short product life cycles, consolidation, and pricing and margin pressures. We expect to continue to depend upon a relatively small number of customers for a significant percentage of our revenue. Consolidation among our customers may further concentrate our business in a limited number of customers and expose us to increased risks relating to dependence on a small number of customers. In addition, a significant reduction in sales to any of our large customers or significant pricing and margin pressures exerted by a key customer would adversely affect our operating results. In the past, some of our large customers have significantly reduced or delayed the volume of manufacturing services ordered from us as a result of changes in their business, consolidations or divestitures or for other reasons. In particular, certain of our customers have from time to time entered into manufacturing divestiture transactions with other EMS companies, and such transactions could adversely affect our revenues with these customers. We cannot assure you that present or future large customers will not terminate their manufacturing arrangements with us or significantly change, reduce or delay the amount of manufacturing services ordered from us, any of which would adversely affect our operating results.

Further restructuring of our operations may adversely affect our financial condition and operating results.

We have incurred expenses related to restructuring in the past, and we anticipate incurring additional restructuring expenses in fiscal 2007. In November 2006, we announced that we intend to focus on joint development manufacturing rather than original design manufacturing to better assist our OEM customers in developing and introducing new products to the market that are more closely aligned to the needs of their customers. We also intend to continue moving our operations from higher-cost locations to lower-cost locations to further enhance profitability. We have incurred unanticipated costs related to the transfer of operations to lower-cost locations, including costs related to integrating new facilities, managing operations in dispersed locations and realigning our business processes. We also have incurred costs related to workforce reductions, work stoppages and labor unrest resulting from the closure of our plants in higher costs locations. We expect to record additional charges related to these actions during fiscal 2007, but we cannot be certain as to the actual amount of the charges or the timing of their recognition for financial reporting purposes. We may need to take additional restructuring charges in the future if our business declines or improves at a slower pace than we anticipate or if the expected benefits of recently completed and currently planned restructuring activities do not materialize. In addition, we may incur unanticipated costs in closing facilities or transitioning operations to new locations that could aversely affect our operating results.

If our backlog decreases in the future, our operating results may be adversely affected.

Our backlog decreased from $1.8 billion in fiscal 2005 to $1.5 billion in fiscal 2006 to $1.4 billion as of March 31, 2007. We cannot predict how our backlog will fluctuate or to what extent business conditions that affect our backlog will change in the future. Due to our relatively fixed cost structure, a significant decline in customer orders could adversely affect our margins. If our backlog declines, or business conditions change for the worse in the future, these events could adversely affect our results of operations and financial condition.

We are subject to intense competition in the EMS industry, and our business may be adversely affected by these competitive pressures.

The EMS industry is highly competitive. We compete on a worldwide basis to provide electronics manufacturing services to OEMs in the communications, personal and business computing, enterprise computing and storage, multimedia, industrial and semiconductor capital equipment, defense and aerospace, medical and automotive industries. Our competitors include major global EMS providers such as Celestica, Inc., Flextronics International Ltd., Hon Hai (FoxConn), Jabil Circuit, Inc., and Solectron Corporation, as well as other EMS companies that have a regional or product, service or industry specific focus. Some of these companies have greater manufacturing and financial resources than we do. We also face competition from current and potential OEM customers who may elect to manufacture their own products internally rather than outsource the manufacturing to EMS providers.

We may not be able to offer prices as low as some of our competitors because those competitors may have lower cost structures as a result of their geographic location or the services they provide or because such competitors are willing to accept business at lower margins in order to utilize more of their excess capacity. If we are unable to offer prices that are competitive with other EMS companies, our net sales would decline. We also expect our competitors to continue to improve the performance of their current products or services, to reduce their current products or service sales prices and to introduce new products or services that may offer greater value-added performance and improved pricing. Any of these could cause a decline in sales, loss of market acceptance of our products or services and a corresponding loss of market share or a decrease in profit margin. We have experienced instances in which customers have transferred all or certain portions of their business to competitors in response to more attractive pricing quotations than we have been willing to offer to retain such customers, and there can be no assurance that we will not lose business in the future in response to such competitive pricing or other inducements which may be offered by our competitors.

Consolidation in the electronics industry may adversely affect our business.

In the current economic climate, consolidation in the electronics industry may increase as companies combine to achieve further economies of scale and other synergies. Consolidation in the electronics industry could result in an increase in excess manufacturing capacity as companies seek to divest manufacturing operations or eliminate duplicative product lines.

Excess manufacturing capacity has increased, and may continue to increase, pricing and competitive pressures for the EMS industry as a whole and for us in particular. Consolidation could also result in an increasing number of very large electronics companies offering products in multiple sectors of the electronics industry. The significant purchasing and market power of these large companies could increase pricing and competitive pressures for us. If one of our customers is acquired by another company that does not rely on us to provide services and has its own production facilities or relies on another provider of similar services, we may lose that customer s business. Any of the foregoing results of industry consolidation could adversely affect our business.

Our failure to comply with applicable environmental laws could adversely affect our business.

We are subject to various federal, state, local and foreign environmental laws and regulations, including those governing the use, storage, discharge and disposal of hazardous substances and wastes in the ordinary course of our manufacturing operations. We also are subject to laws and regulations governing the recyclability of products, the materials that may be included in products, and the obligations of a manufacturer to dispose of these products after end users have finished using them. If we violate environmental laws, we may be held liable for damages and the costs of remedial actions and may be subject to revocation of permits necessary to conduct our businesses. We cannot assure you that we will not violate environmental laws and regulations in the future as a result of our inability to obtain permits, human error, equipment failure or other causes. Any permit revocations could require us to cease or limit production at one or more of our facilities, which could adversely affect our business, financial condition and operating results. Although we estimate our potential liability with respect to violations or alleged violations and reserve for such liability, we cannot assure you that any accruals will be sufficient to cover the actual costs that we incur as a result of these violations or alleged violations. Our failure to comply with applicable environmental laws and regulations could limit our ability to expand facilities or could require us to acquire costly equipment or to incur other significant expenses to comply with these laws and regulations.

Over the years, environmental laws have become, and in the future may become, more stringent, imposing greater compliance costs and increasing risks and penalties associated with violations. We operate in several environmentally sensitive locations and are subject to potentially conflicting and changing regulatory agendas of political, business and environmental groups. Changes in or restrictions on discharge limits, emissions levels, permitting requirements and material storage or handling could require a higher than anticipated level of operating expenses and capital investment or, depending on the severity of the impact of the foregoing factors, costly plant relocation.

In addition, the electronics industry became subject to the European Union s Restrictions of Hazardous Substances, or RoHS, and Waste Electrical and Electronic Equipment, or WEEE, directives which took effect beginning in 2005 and continuing in 2006. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and the People s Republic of China. RoHS prohibits the use of lead, mercury and certain other specified substances in electronics products and WEEE requires industry OEMs to assume responsibility for the collection, recycling and management of waste electronic products and components. We are in the process of making our manufacturing process RoHs compliant. In the case of WEEE, the compliance responsibility rests primarily with OEMs rather than with EMS companies. However, OEMs may turn to EMS companies for assistance in meeting their WEEE obligations. In the event we are not able to make our manufacturing obligations fully RoHS compliant, we could be unable to certify compliance to our customers and could incur substantial costs, including fines and penalties, as well as liability to our customers. In addition, we may incur costs related to inventories containing restricted substances that are not consumed by the RoHS effective dates.

We are potentially liable for contamination of our current and former facilities, including those of the companies we have acquired, which could adversely affect our business and operating results in the future.

We are potentially liable for contamination at our current and former facilities, including those of the companies we have acquired. These liabilities include ongoing investigation and remediation activities at a number of sites. Currently, we are unable to anticipate whether any third-party claims will be brought against us for this contamination. We cannot assure you that third-party claims will not arise and will not result in material liability to us. In addition, there are several sites that are known to have groundwater contamination caused by a third party, and that third party has provided an indemnity to us for the liability. Although we do not currently expect to incur liability for clean-up costs or expenses at any of these sites, we cannot assure you that we will not incur such liability or that any such liability would not be material to our business and operating results in the future.

Our key personnel are critical to our business, and we cannot assure you that they will remain with us.

Our success depends upon the continued service of our executive officers and other key personnel. Generally, these employees are not bound by employment or non-competition agreements. We cannot assure you that we will retain our officers and key employees, particularly our highly skilled design, process and test engineers involved in the manufacture of existing products and development of new products and processes. The competition for these employees is intense. In addition, if Jure Sola, our chairman and chief executive officer, or one or more of our other executive officers or key employees, were to join a competitor or otherwise compete directly or indirectly with us or otherwise be unavailable to us, our business, operating results and financial condition could be adversely affected.

Unanticipated changes in our tax rates or in our assessment of the realizability of our deferred tax assets or exposure to additional income tax liabilities could affect our operating results and financial condition.

We are subject to income taxes in both the United States and various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and, in the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. Our effective tax rates could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws as well as other factors. Our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Although we believe that our tax estimates are reasonable, the final determination of tax audits or tax disputes may be different from what is reflected in our historical income tax provisions which could affect our operating results.

During the second quarter of fiscal 2005 and the fourth quarter of fiscal 2006, we recorded goodwill impairment losses of $600.0 million and $3.7 million, respectively, and there can be no assurance that it will not be necessary to record additional goodwill impairment or long-lived asset impairment charges in the future.

During the quarters ended April 2, 2005 and September 30, 2006, we recorded goodwill impairment losses of $600.0 million and $3.7 million, respectively. The factors that led us to record a write-off of our deferred tax assets, which primarily related to U.S. operations, coupled with a decline in the market price of our common stock, led us to record the $600.0 million goodwill impairment loss. In particular, the shift of operations from U.S. facilities and other facilities in high cost locations to facilities in lower-cost locations has resulted in restructuring charges and a decline in sales with respect to our U.S. operations. In the event that the results of operations do not stabilize or improve, or the market price of our common stock declines further or does not rise, we could be required to record additional goodwill impairment or other long-lived asset impairment charges during fiscal 2007 or in future fiscal periods. Although these goodwill impairment charges are of a non-cash nature, they do adversely affect our results of operations in the periods in which such charges are recorded.

We are subject to risks arising from our international operations.

We conduct our international operations primarily in Asia, Latin America, Canada and Europe, and we continue to consider additional opportunities to make foreign acquisitions and construct new foreign facilities. We generated 75.3% of our net sales from non-U.S. operations during the first half of fiscal 2007, and a significant portion of our manufacturing material was provided by international suppliers during this period. During fiscal 2006, we generated 75.1% of our net sales from non-U.S. operations. As a result of our international operations, we are affected by economic and political conditions in foreign countries, including:

- the imposition of government controls;
- export license requirements;
- political and economic instability, including armed conflicts;
- trade restrictions;
- changes in tariffs;
- labor unrest and difficulties in staffing;
- inflexible employee contracts in the event of business downturns;
- coordinating communications among and managing international operations;
- fluctuations in currency exchange rates;
- increases in duty and/or income tax rates;
- earnings repatriation restrictions;
- difficulties in obtaining export licenses;
- misappropriation of intellectual property; and
- constraints on our ability to maintain or increase prices.

To respond to competitive pressures and customer requirements, we may further expand internationally in lower cost locations, particularly in Asia, Eastern Europe and Latin America. As we pursue continued expansion in these locations, we may incur additional capital expenditures. In addition, the cost structure in certain countries that are now viewed as low-cost may increase as economies develop or as such countries join multinational economic communities or organizations. For example, Hungary, in which we have operations, is in the process of joining the European Union, and it is possible that costs in Hungary could therefore increase. As a result, we may need to continue to seek out new locations with lower costs and the employee and infrastructure base to support electronics manufacturing. We cannot assure you that we will realize the anticipated strategic benefits of our international operations or that our international operations will contribute positively to, and not adversely affect, our business and operating results.

During fiscal 2005 and fiscal 2006, the decline in the value of the U.S. dollar as compared to the Euro and many other currencies has resulted in foreign exchange losses. To date, these losses have not been material to our results of operations. However, continued fluctuations in the value of the U.S. dollar as compared to the Euro and other currencies in which we transact business could adversely affect our operating results.

We are subject to risks of currency fluctuations and related hedging operations.

A portion of our business is conducted in currencies other than the U.S. dollar. Changes in exchange rates among other currencies and the U.S. dollar will affect our cost of sales, operating margins and revenues. We cannot predict the impact of future exchange rate fluctuations. In addition, certain of our subsidiaries that have non-U.S. dollar functional currencies transact business in U.S. dollars. We use financial instruments, primarily short-term foreign currency forward contracts, to hedge U.S. dollar and other currency commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations. If these hedging activities are not successful or we change or reduce these hedging activities in the future, we may experience significant unexpected expenses from fluctuations in exchange rates.

We may not be successful in implementing strategic transactions, including business acquisition and divestitures, and we may encounter difficulties in completing these transactions and integrating acquired businesses or in realizing anticipated benefits of strategic transactions, which could adversely affect our operating results.

We seek to undertake strategic transactions that give us the opportunity to access new customers and new end-customer markets, to obtain new manufacturing and service capabilities and technologies, to enter new geographic manufacturing locations, to lower our manufacturing costs and improve the margins on our product mix, and to further develop existing customer relationships. Strategic transactions may involve difficulties, including the following:

- integrating acquired operations and businesses;
- allocating management resources;
- scaling up production and coordinating management of operations at new sites;
- separating operations or support infrastructure for entities divested;
- managing and integrating operations in geographically dispersed locations;
- maintaining customer, supplier or other favorable business relationships of acquired operations and terminating unfavorable relationships;
- integrating the acquired company s systems into our management information systems;
- separating management information systems for entities to be divested;
- addressing unforeseen liabilities of acquired businesses;
- lack of experience operating in the geographic market or industry sector of the business acquired;
- improving and expanding our management information systems to accommodate expanded operations; and
- losing key employees of acquired operations.

Any of these factors could prevent us from realizing the anticipated benefits of a strategic transaction, and our failure to realize these benefits could adversely affect our business and operating results. We may not be successful in identifying future strategic opportunities or in consummating any strategic transactions that we pursue on favorable terms, if at all. Although our goal is to improve our business and maximize stockholder value, any transactions that we complete may impair stockholder or debtholder value or otherwise adversely affect our business and the market price of our stock. Moreover, any such transaction may require us to incur related charges, and may pose significant integration challenges and/or management and business disruptions, any of which could harm our operating results and business.

In addition, we recently announced our intention to create a more separable personal and business computing business unit comprised of our personal computing and low-end servers and storage businesses, their related bill to order and configure to order operations and their associated logistics activities. We believe that the creation of a more separable personal and business computing business unit will enhance our capability and flexibility in pursuing strategic alliances that can accelerate the pursuit of component vertical integration, product design and growth opportunities. We also believe it will allow us to consider potential strategic opportunities to maximize the value of our personal and business computing business.

If we are unable to protect our intellectual property or infringe, or are alleged to infringe, upon intellectual property of others, our operating results may be adversely affected.

We rely on a combination of copyright, patent, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We cannot be certain that the steps we have taken will prevent unauthorized use of our technology. Our inability to protect our intellectual property rights could diminish or eliminate the competitive advantages that we derive from our proprietary technology.

We may become involved in litigation in the future to protect our intellectual property or because others may allege that we infringe on their intellectual property. These claims and any resulting lawsuits could subject us to significant liability for damages and invalidate our proprietary rights. In addition, these lawsuits, regardless of their merits, likely would be time consuming and expensive to resolve and would divert management s time and attention. Any potential intellectual property litigation alleging our infringement of a third-party s intellectual property also could force us or our customers to:

- stop producing products that use the challenged intellectual property;
- obtain from the owner of the infringed intellectual property a license to sell the relevant technology at an additional cost, which license may not be available on reasonable terms, or at all; and
- redesign those products or services that use the infringed technology.

Any costs we incur from having to take any of these actions could be substantial.

We and the customers we serve are vulnerable to technological changes in the electronics industry.

Our customers are primarily OEMs in the communications, high-end computing, personal computing, aerospace and defense, medical, industrial controls and multimedia sectors. These industry sectors, and the electronics industry as a whole, are subject to rapid technological change and product obsolescence. If our customers are unable to develop products that keep pace with the changing technological environment, our customers products could become obsolete and the demand for our services could decline significantly. In addition, our customers may discontinue or modify products containing components that we manufacture or develop products requiring new manufacturing processes. If we are unable to offer technologically advanced, easily adaptable and cost effective manufacturing services in response to changing customer requirements, demand for our services will decline. If our customers terminate their purchase orders with us or do not select us to manufacture their new products, our operating results could be adversely affected.

We may experience component shortages, which could cause us to delay shipments to customers and reduce our revenue and operating results.

We are dependent on certain suppliers, including limited and sole source suppliers, to provide key components we incorporate into our products. We have experienced, and may continue to experience, delays in component deliveries, which in turn could cause delays in product shipments and require the redesign of certain products. In addition, if we are unable to procure necessary components under favorable purchase terms, including at favorable prices and with the order lead-times needed for the efficient and profitable operation of our factories, our results of operations could suffer. In the past, we have experienced shortages of application-specific integrated circuits, capacitors and connectors as well as other components. We may experience component shortages from time to time in the future. Unanticipated component shortages have prevented us from making scheduled shipments to customers in the past and may do so in the future. Our inability to make scheduled shipments could cause us to experience a shortfall in revenue, increase our costs and adversely affect our relationship with the affected customer and our reputation generally as a reliable service provider. Component shortages may also increase our cost of goods sold because we may be required to pay higher prices for components in short supply and redesign or reconfigure products to accommodate substitute components. In addition, we may purchase components in advance of our requirements for those components as a result of a threatened or anticipated shortage. In this event, we will incur additional inventory carrying costs, for which we may not be compensated, and have a heightened risk of exposure to inventory obsolescence. As a result, component shortages could adversely affect our operating results for a particular period due to the resulting revenue shortfall and increased manufacturing or component costs.

If we manufacture or design defective products, or if our manufacturing processes do not comply with applicable statutory and regulatory requirements, demand for our services may decline and we may be subject to liability claims.

We manufacture products to our customers specifications, and in some cases our manufacturing processes and facilities may need to comply with applicable statutory and regulatory requirements. For example, medical devices that we manufacture, as well as the facilities and manufacturing processes that we use to produce them, are regulated by the Food and Drug Administration. In addition, our customers products and the manufacturing processes that we use to produce them often are highly complex. As a result, products that we manufacture or design may at times contain design or manufacturing defects, and our manufacturing processes may be subject to errors or not be in compliance with applicable statutory and regulatory requirements. Defects in the products we manufacture or design may result in delayed shipments to customers or reduced or cancelled customer orders. If these defects or deficiencies are significant, our business reputation may also be damaged. The failure of the products that we manufacture or design or of our manufacturing processes and facilities to comply with applicable statutory and regulatory requirements may subject us to legal fines or penalties and, in some cases, require us to shut down or incur considerable expense to correct a manufacturing program or facility. In addition, these defects may result in liability claims against us. The magnitude of such claims may increase as we expand our medical, automotive, and aerospace and defense manufacturing services because defects in medical devices, automotive components, and aerospace and defense systems could seriously harm users of these products. Even if our customers are responsible for the defects, they may not, or may not have the resources to, assume responsibility for any costs or liabilities arising from these defects.

The filing of restated financial statements could adversely affect our financial results.

We have completed an investigation of our accounting for stock options in October 2006. Based on the results of this investigation on January 3, 2007, we filed a comprehensive Form 10-K for 2006 which restated our consolidated financial statements for prior years. As a result of this activity, we have become subject to the following significant risks. Each of these risks could have an adverse effect on our business, financial condition and results of operations:

- we are subject to significant pending civil litigation, including shareholder class action lawsuits and derivative claims made on behalf of us, the defense of which will require us to devote significant management attention and to incur significant legal expense and which litigation, if decided against us, could require us to pay substantial judgments, settlements or other penalties;

- we are subject to an ongoing informal investigation by the SEC and other governmental agencies which could require significant management time and attention and cause us to incur significant accounting and legal expense and which could require us to pay substantial fines or other penalties;

- we are subject to the risk of additional litigation and regulatory proceedings or actions;

- many members of our senior management team and our Board of Directors have been and will be required to devote a significant amount of time on matters relating to the continuing informal SEC and other governmental agencies investigations, remedial efforts and related litigation.

If our products are subject to warranty or liability claims, we may incur significant costs.

Our customers may experience defects in our designs or deficiencies with respect to our manufacturing services. We may be exposed to warranty or manufacturers liability claims as a result of these defects or deficiencies, and some claims may relate to customer product recalls. We also design products on a contract basis or jointly with our customers. The design services that we provide can expose us to different or greater potential liabilities than those we face when providing our regular manufacturing services. For example, we have increased exposure to potential product liability claims resulting from injuries caused by defects in products we design, as well as potential claims that products we design infringe third-party intellectual property rights. Such claims could subject us to significant liability for damages and, regardless of their merits, could be time-consuming and expensive to resolve. We also may have greater potential exposure from warranty claims and from product recalls due to problems caused by product design. A claim for damages arising from such defects or deficiencies could have a material adverse effect on our business, results of operations and financial condition. A claim for such damages, or a product recall conducted by one of our customers, also could have an adverse effect on our business reputation.

We may not have sufficient insurance coverage for certain of the risks and liabilities we assume in connection with the products and services we provide to our customers.

We carry various forms of business and liability insurance that we believe are typical for companies in our industry. However, we may not have sufficient insurance coverage for certain risks and liabilities we assume in connection with the products and services we provide to our customers, such as potential warranty, product liability and product recall claims. Such liability claims may only be partially covered under our insurance policies. We continue to monitor the insurance marketplace to evaluate the need to obtain additional insurance coverage in the future. Costs associated with potential claims and liabilities for which we do not have sufficient insurance coverage could have a material adverse effect on our results of operations, financial condition and liquidity.

Changes in financial accounting standards or policies have affected, and in the future, may affect, our reported financial condition or results of operations. Additionally, changes in securities laws and regulations have increased, and are likely to continue to increase, our operating costs.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States, or U.S. GAAP. These principles are subject to interpretation by the FASB, the American Institute of Certified Public Accountants (AICPA), the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions which are completed before a change is announced.

Accounting policies affecting many other aspects of our business, including rules relating to revenue recognition, off-balance sheet transactions, stock-based compensation, restructurings, asset disposals and asset retirement obligations, intangible assets, derivative and other financial instruments, and in-process research and development charges, have recently been revised or are under review. Changes to those rules or the questioning of how we interpret or implement those rules may have a material adverse effect on our reported financial results or on the way we conduct business. In addition, our preparation of financial statements in accordance with U.S. GAAP requires that we make estimates and assumptions that affect the recorded amounts of assets and liabilities, disclosure of those assets and liabilities at the date of the financial statements and the recorded amounts of expenses during the reporting period. A change in the facts and circumstances surrounding those estimates could result in a change to our estimates and could impact our future operating results.

The Sarbanes-Oxley Act of 2002 required changes in our corporate governance, public disclosure and compliance practices. The number of rules and regulations applicable to us has increased and will continue to increase our legal and financial compliance costs, and have made some activities more difficult, such as by requiring stockholder approval of new option plans. We also expect these developments to make it more difficult and more expensive 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 developments could make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers. In addition, in connection with our Section 404 certification process, we may identify from time to time deficiencies in our internal controls. Any material weakness or deficiency in our internal controls over financial reporting could materially and negatively impact our reported financial results and the market price of our stock could significantly decline. Additionally, adverse publicity related to the disclosure of a material weakness or deficiency in internal controls over financial reporting could have a negative impact on our reputation, business and stock price.

We are subject to risks associated with natural disasters and global events.

We conduct a significant portion of our activities including manufacturing, administration and data processing at facilities located in the State of California and other seismically active areas that have experienced major earthquakes in the past, as well as other natural disasters. Our insurance coverage with respect to natural disasters is limited and is subject to deductibles and coverage limits. Such coverage may not be adequate or continue to be available at commercially reasonable rates and terms. In the event of a major earthquake or other disaster affecting one or more of our facilities, it could significantly disrupt our operations, delay or prevent product manufacture and shipment for the time required to transfer production, repair, rebuild or replace the affected manufacturing facilities. This time frame could be lengthy and result in significant expenses for repair and related costs. In addition, concerns about terrorism or an outbreak of epidemic diseases could have a negative effect on travel and our business operations and result in adverse consequences on our business and results of operations.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

Interest Rate Risk

Our exposures to market risk for changes in interest rates relate primarily to our investment portfolio and certain debt obligations. Currently, we do not use derivative financial instruments in our investment portfolio. We invest in high quality credit issuers and, by policy, limit the amount of principal exposure to any one issuer. As stated in our policy, we seek to ensure the safety and preservation of our invested principal funds by limiting default and market risk.

We seek to mitigate default risk by investing in high quality credit securities and by positioning our investment portfolio to respond to a significant reduction in credit rating of any investment issuer, guarantor or depository. We seek to mitigate market risk by limiting the principal and investment term of funds held with any one issuer and by investing funds in marketable securities with active secondary or resale markets. As of March 31, 2007, we had no short-term investments.

We have issued the 6.75% Notes with a principal balance of $400.0 million due in 2013. We entered into interest rate swap transactions with independent third parties to effectively convert the fixed interest rate obligation to a variable rate obligation. The swap agreements, which expire in 2013, are accounted for as fair value hedges under SFAS No. 133. The aggregate notional amount of the combined swap transactions is $400.0 million. Under the terms of the swap agreements, we pay the independent third parties an interest rate equal to the six-month LIBOR rate plus a spread ranging from 2.214% to 2.250%. In exchange, we receive a fixed rate of 6.75%. At March 31, 2007 and September 30, 2006, $14.1 million and $17.1 million, respectively, has been recorded in other long-term liabilities to record the fair value of the interest rate swap transactions, with a corresponding decrease to the carrying value of the 6.75% Notes on the Condensed Consolidated Balance Sheets.

We entered into a Credit and Guaranty Agreement (the Term Loan Agreement) providing for a $600.0 million senior unsecured term loan which matures on January 31, 2008. The loans will bear interest at our election at either the prime rate plus a margin or at an adjusted LIBOR rate plus 2.5%. On the 181st day after closing, the margins with respect to all loans will increase by 0.5% for the remaining life of the loans.

Since certain of our debt as of March 31, 2007 are floating rate debt instruments, a 10% increase in interest rate at March 31, 2007 would result in an increase in annual gross interest expense of approximately $9.7 million. Similarly, a 10% reduction in interest rate would result in a reduction in annual interest expense of approximately $9.7 million.

Foreign Currency Exchange Risk

We transact business in foreign countries. Our primary foreign currency cash flows are in certain Asian and European countries, Australia, Brazil, Canada, and Mexico. We enter into short-term foreign currency forward contracts to hedge currency exposures associated with certain assets and liabilities denominated in foreign currencies. These contracts typically have maturities of three months or less. Further, these contracts are not designated as part of a hedging relationship in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133). At March 31, 2007 and September 30, 2006, we had forward contracts to exchange various foreign currencies for U.S. dollars in the aggregate notional amount of $263.9 million and $403.4 million, respectively. The net unrealized loss on the contracts at March 31, 2007 was not material and was recorded in accrued liabilities on the Condensed Consolidated Balance Sheet. Realized gains and losses on forward exchange contracts are recognized in the Condensed Consolidated Statement of Operations in other income (expense), net. The net impact of these foreign exchange contracts was not material to the results of operations for the three and six months ended March 31, 2007 and April 1, 2006.

We also utilize foreign currency forward and option contracts to hedge certain forecasted foreign currency sales and cost of sales referred to as cash flow hedges which qualify for hedge accounting under SFAS No. 133. These contracts typically are less than 12 months. Gains and losses on these contracts related to the effective portion of the hedges are recorded in other comprehensive income until the forecasted transactions impact earnings. Gains and losses related to the ineffective portion of the hedges are immediately recognized in the Condensed Consolidated Statements of Operations. At March 31, 2007 and September 30, 2006, we had forward and option contracts related to cash flow hedges in various foreign currencies in the aggregate notional amount of $49.5 million and $10.1 million, respectively. The net unrealized gain on the contracts at March 31, 2007 was not material and was recorded in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheets. The net impact of these foreign exchange forward and option contracts was not material to the results of operations for the three and six months ended March 31, 2007 and April 1, 2006.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

Based on our management s evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Control Over Financial Reporting

There were several changes in our internal control over financial reporting during the second quarter of fiscal 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. These changes relate to internal controls that were designed and implemented to address the material weakness that we identified in November 2006 and include:

- Establishing fixed dates for the granting of all equity-based awards.

- Segregating and reassigning responsibilities relating to compensation administration and stock administration, each of which were previously administered outside of the oversight of the finance organization. The stock administration program will be administered and managed by the finance department.

- Creation and implementation of formal, documented stock option grant procedures and practices such as establishing and documenting the authority to grant stock options, protocols in regards to establishing the effective date and exercise price of options.

- Establishment of additional education and training for personnel and directors in areas associated with the stock option granting processes and other compensation practices to increase competency levels of the personnel involved.

- Ensuring that the actions taken by the Compensation Committee are accurately documented and reported to the Board of Directors in a timely manner.

- Requiring documented, verifiable evidence of the date of approval for routine new hire, promotion and certain discretionary grants and mandating approval of the Compensation Committee prior to issuance of all other grants.

We completed the process of implementing the aforementioned changes during the second quarter of fiscal 2007.

Inherent Limitations of Disclosure Controls and Internal Control Over Financial Reporting

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

We are a so-called nominal defendant party to multiple shareholder derivative lawsuits that were filed following our June 9, 2006 announcement that we had initiated an internal inquiry into our historical stock option administration practices. In particular, five separate shareholder derivative actions have been filed and consolidated into a single proceeding pending in the United States District Court for the Northern District of California, captioned *In re Sanmina-SCI Corporation Derivative Litigation*, Master File No. C-06-3783-JF. The first of these consolidated actions was filed June 15, 2006. A consolidated complaint was filed on October 30, 2006. In addition, three related shareholder derivative actions have been filed in Superior Court for the State of California, County of Santa Clara. These three actions, captioned *Salehinasab v. Sola, et al.,* Case No. 1-06-CV-071786 (filed September 25, 2006); *Bahnmiller v. Sola, et al.,* Case No. 1-06-CV-074989 (filed November 17, 2006); and *Judd v. Sola, et al.,* Case No. 1-06-CV-075019 (filed November 17, 2006), have also been consolidated. Derivative plaintiffs intend to file a consolidated complaint, and responses to the initial complaints have been suspended at least until after the consolidated complaint is filed.

In all of these actions, the derivative plaintiffs allege that they are our shareholders and purport to bring the actions on our behalf and for our benefit. This is why we are a nominal defendant party to each of these actions; no relief is sought against us in these lawsuits and any recovery (net of any court award of attorneys fees and costs to derivative plaintiffs counsel) would belong to us. While the list of defendants varies from action to action, 27 different current and former directors and officers have been named as defendants in one or more of the actions. The defendants include Rick Ackel, Samuel Altschuler, John Bolger, Neil R. Bonke, Stephen F. Bruton, Michael J. Clarke, Alain A. Couder, Randy W. Furr, Steven H. Jackman, Elizabeth J. Jordan, Michael Landy, Christopher D. Mitchell, Eric Naroian, Hari Pillai, Carmine Renzulli, Mario M. Rosati, A. Eugene Sapp, Jr., Joseph Schell, Wayne Shortridge, Peter J. Simone, Jure Sola, Michael Sparacino, Michael Sullivan, Jacquelyn M. Ward, David White, Bernard Whitney and Dennis Young. The derivative plaintiffs allege generally that the individual defendants manipulated the grant dates of our stock options between 1995 and 2006, allegedly in breach of duties owed to us and our shareholders, causing us to report our financial results inaccurately and resulting in harm to us. Plaintiffs seek money damages against the individual defendants, an accounting for damages allegedly caused by the individual defendants, disgorgement of profits allegedly improperly obtained by the defendants, and various other types of equitable and injunctive relief. In August 2006, our Board of Directors created a Special Litigation Committee comprised of directors Alain A. Couder and Peter J. Simone, and vested that committee with the full authority on our behalf to investigate the claims asserted by the derivative plaintiffs, and to determine what action should be taken with respect to the shareholder derivative actions including without limitation whether we should pursue claims against the named defendants or other persons. The Special Litigation Committee s investigation is substantially concluded although it has not yet issued a formal report. Both the federal and state courts ordered temporary stays of the derivative plaintiffs prosecution of the shareholder derivative lawsuits to permit the Special Litigation Committee reasonable time to consider the matters alleged by the derivative plaintiffs and to determine appropriate action in response to the lawsuit. Both courts have scheduled status conferences in the respective cases for late May. In the meantime, the parties are discussing the possibility of reaching an early appropriate resolution of the litigations in light of the Special Litigation Committee s tentative conclusions. Although the shareholder derivative lawsuits do not seek damages or other relief against us, we do owe certain indemnification obligations to our current and former directors, officers and employees involved with the stock option-related proceedings, particularly to the extent that individuals are found not to have engaged in any wrongdoing. We cannot currently predict whether the shareholder derivative lawsuits will result in any material net recovery for us.

Additionally, we are aware that the Securities and Exchange Commission, the United States Attorney for the Northern District of California, and the Department of Labor are conducting inquiries into our historical stock option administration practices. We have received informal requests for documents and other information from the Securities and Exchange Commission and a grand jury subpoena from the United States Attorney. We also have received an information document request from the Internal Revenue Service in connection with certain historical stock option awards. Further, the Department of Labor is conducting an audit. We are cooperating fully with these investigations.

In addition, we are a party to certain legal proceedings that have arisen in the ordinary course of our business. We believe that the resolution of these proceedings will not have a material adverse effect on our business, financial condition or results of operations.

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

On February 26, 2007, Sanmina-SCI held its 2007 Annual Meeting of Stockholders. The matters voted upon at the meeting for shareholders of record as of January 16, 2007 and the vote with respect to each such matter are set forth below:

1. To elect directors of Sanmina-SCI Corporation:

	For	Withheld
Neil R. Bonke	338,004,848	70,121,288
Alain Couder	434,813,732	17,625,384
Mario M. Rosati	391,271,768	51,786,007
A. Eugene Sapp, Jr	406,890,940	45,076,704
Wayne Shortridge	388,418,025	40,705,334
Peter J. Simone	419,238,039	24,519,546
Jure Sola	359,737,983	68,471,014
Jacquelyn M. Ward	387,502,543	40,753,164

2. To approve appointment of KPMG LLP as the independent public accountants of Sanmina-SCI for the fiscal year ending September 29, 2007.

For: 414,500,240 Against: 37,217,732 Abstain: 3,055,280

Item 6. ***Exhibits***

(a) *Exhibits*

Refer to item (c) below.

(c) *Exhibits*

Exhibit Number	**Description**
3.1(1)	Restated Certificate of Incorporation of the Registrant, dated January 31, 1996.
3.1.1(2)	Certificate of Amendment of the Restated Certificate of Incorporation of the Registrant, dated March 9, 2001.
3.1.2(3)	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Registrant, dated May 31, 2001.
3.1.3(4)	Certificate of Amendment of the Restated Certificate of Incorporation of the Registrant, dated December 7, 2001.
3.2(5)	Amended and Restated Bylaws of the Registrant, dated December 4, 2006.
31.1	Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

Total consolidated net earnings	
	$ 21,851
	22,227
	40,523
	36,272

	June 30, 2007	2006
	(In thousands)	
Assets:		
Total segment assets	$ 6,741,685	6,458,892
Other unallocated assets	22,708	20,319
Total consolidated assets	$ 6,764,393	6,479,211

(7) SHARE-BASED PAYMENTS

The Company has a stock and incentive plan ("Plan") which provides for the grant of any or all of the following types of awards to eligible employees: (1) stock options, including incentive stock options and nonqualified stock options; (2) stock appreciation rights, in tandem with stock options or freestanding; (3) restricted stock; (4) incentive awards; and (5) performance awards. The Plan began on April 21, 1995, and was to terminate on April 20, 2005, unless terminated earlier by the Board of Directors. The Plan was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, $1.00 par value, common stock which may be issued under the Plan, or as to which stock appreciation rights or other awards may be granted, may not exceed 300,000. These shares may be authorized and unissued shares. The Company has only issued nonqualified stock options.

All of the employees of the Company and its subsidiaries are eligible to participate in the Plan. In addition, directors of the Company, other than Compensation and Stock Option Committee members, are eligible for restricted stock awards, incentive awards, and performance awards. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. The directors' stock options vest 20% annually following one full year of service to the Company from the date of grant. The officers' stock options vest 20% annually following three full years of service to the Company from the date of grant. Options issued expire after ten years. No awards were issued in 2007 or 2006.

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Through December 31, 2005, the Company classified the Plan as equity, and as such, utilized the grant date fair value method to measure compensation. Effective March 10, 2006, as more fully described below, the Company's Plan classification was changed to liability and accordingly, the Company began using the current fair value method to measure compensation cost. A summary of shares available for grant and stock option activity is detailed below.

	Shares Available For Grant	Options Outstanding Shares	Options Outstanding Weighted-Average Exercise Price
Balance at January 1, 2007	26,477	128,465	$ 123.00
Stock Options:			
Exercised	-	(23,560)	105.89
Forfeited	1,110	(1,110)	131.23
Expired	81	(81)	85.13
Balance at June 30, 2007	27,668	103,714	$ 126.82

The total intrinsic value of options exercised was $3.3 million and $1.1 million for the six months ended June 30, 2007 and 2006, respectively. The total share-based liabilities paid were $3.1 million for the six months ended June 30, 2007. The total fair value of shares vested during the six months ended June 30, 2007 and 2006 was $3.0 million and $2.6 million, respectively.

The following table summarizes information about stock options outstanding at June 30, 2007.

	Options Outstanding Number Outstanding	Options Outstanding Weighted-Average Remaining Contractual Life	Options Exercisable
Exercise prices:			
$105.25	8,130	1.0 years	8,130
112.38	5,800	1.2 years	5,800
92.13	24,634	4.1 years	17,586
95.00	7,200	4.2 years	7,200
150.00	57,950	7.1 years	13,950
Totals	103,714		52,666
Aggregate intrinsic value (in thousands)	$ 13,178		$ 7,467

The aggregate intrinsic value in the table above is based on the closing stock price of $253.89 per share on June 30, 2007.

In estimating the fair value of the options outstanding at June 30, 2007, the Company employed the Black-Scholes option pricing model with assumptions as detailed below.

	2007	2006
Expected term of options	2 to 6 years	1 to 6 years
Expected volatility:		
Range	15.54% to 23.27%	15.53% to 24.35%
Weighted-average	17.61%	21.12%
Expected dividends	-	-
Risk-free rate:		
Range	4.93% to 5.05%	5.07% to 5.31%
Weighted-average	4.99%	5.21%

The Company reviewed the contractual term relative to the options as well as perceived future behavior patterns of exercise. Volatility is based on historical volatility over the expected term.

The pre-tax compensation cost recognized in the financial statements related to the Plan was $2.6 million and $13.9 million for the six months ended June 30, 2007 and 2006, respectively. The related tax benefit recognized was $0.9 million and $4.9 million for the six months ended June 30, 2007 and 2006, respectively.

Effective March 10, 2006, the Company adopted and implemented a limited stock buy-back program which provides option holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. The buy-back program did not alter the terms and conditions of the Plan, however the program necessitated a change in accounting from the equity classification to the liability classification. The modification affected 35 plan participants who had options outstanding on the date of modification and resulted in $11.7 million of total incremental pre-tax compensation cost due to the change from the equity to liability classification.

As of June 30, 2007, the total compensation cost related to nonvested options not yet recognized was $2.5 million. This amount is expected to be recognized over a weighted-average period of 2 years. The Company recognizes compensation cost over the graded vesting periods.

For the six months ended June 30, 2007 and 2006, the total cash received from the exercise of options under the Plan was $0.1 million and $0.5 million, respectively.

(8) FEDERAL INCOME TAXES

During the second quarter of 2007, upon the completion of a detailed review of the deferred tax items, the Company identified a $2.3 million error in the net deferred tax liability. The error, which occurred during various periods prior to 2005, was corrected in the second quarter of 2007 and resulted in a decrease in the net deferred tax liability and deferred tax expense. The adjustment was not material to the current period or any prior period financial statements.

(9) LEGAL PROCEEDINGS

In the course of an audit of a charitable tax-exempt foundation, the Internal Revenue Service (“IRS”) raised an issue under the special provisions of the Internal Revenue Code (“IRC”) governing tax-exempt private foundations as to certain interest-bearing loans from the Company to another corporation in which the tax-exempt foundation owns stock. The issue was whether such transactions constitute indirect self-dealing by the foundation, the result of which would be excise taxes on the Company by virtue of its participation in such transactions. By letter to the Company dated August 21, 2003, the IRS proposed an initial excise tax liability in the total amount approximating one million dollars as a result of such transactions. The Company disagreed with the IRS analysis. The Company contested and requested that this issue instead be referred to the IRS National Office for technical advice. The IRS audit team agreed and the matter was referred in November of 2003 to the IRS National Office. Such technical advice was subsequently issued by the IRS National Office in the form of a memorandum analyzing the issue which concluded that such loans do not constitute indirect self-dealing. This technical advice memorandum is binding on the IRS audit team.

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The Company is a defendant in three class action lawsuits, and one class has been certified regarding an alleged violation of section 17200 of the California Business and Professions Code. Management believes that the Company has good and meritorious defenses and intends to continue to vigorously defend itself against these claims.

The Company is involved or may become involved in various other legal actions, in the normal course of business, in which claims for alleged economic and punitive damages have been or may be asserted, some for substantial amounts. Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from potential, pending, or threatened legal actions, will have a material adverse effect on the financial condition or operating results of the Company.

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

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information contained herein or in other written or oral statements made by or on behalf of National Western Life Insurance Company or its subsidiaries is or may be viewed as forward-looking. Although the Company has used appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's filings with the Securities and Exchange Commission ("SEC") such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However National Western, as a matter of policy, does not make any specific projections as to future earnings, nor does it endorse any projections regarding future performance that may be made by others. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable events or developments. Also, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise.

OVERVIEW

Insurance Operations - Domestic

The Company is currently licensed to do business in all states except for New York. Products marketed are annuities, universal life insurance, equity-indexed annuities and universal life, and traditional life insurance, which include both term and whole life products. The Company’s domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and equity-indexed annuities. Most of these annuities can be sold as tax qualified or nonqualified products. At June 30, 2007, the Company maintained approximately 122,100 annuity policies in force.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the Company in recruiting, contracting, and managing independent agents. The Company currently has approximately 6,500 independent agents contracted. Roughly 25% of these contracted agents have submitted policy applications to the Company in the past twelve months.

Insurance Operations - International

The Company's international operations focus on foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, Eastern Europe, Asia and the Pacific Rim. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At June 30, 2007, the Company had approximately 70,100 international life insurance policies in force representing approximately $13.8 billion in face amount of coverage.

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International applications are submitted by independent contractor consultants and broker-agents. The Company has approximately 4,700 independent international consultants and brokers currently contracted, 44% of which have submitted policy applications to the Company in the past twelve months.

There are some inherent risks of accepting international applications which are not present within the domestic market that are reduced substantially by the Company in several ways. As previously described, the Company accepts applications from foreign nationals in upper socioeconomic classes who have substantial financial resources. This targeted customer base coupled with the Company's conservative underwriting practices have historically resulted in claims experience, due to natural causes, similar to that in the United States. The Company minimizes exposure to foreign currency risks by requiring payment of premiums, claims and other benefits almost entirely in United States dollars. Finally, the Company's forty years of experience with the international products and its longstanding independent consultant and broker-agent relationships further serve to minimize risks.

SALES

Life Insurance

The following table sets forth information regarding the Company's life insurance sales activity as measured by annualized first year premiums. While the figures shown below are in accordance with industry practice and represent the amount of new business sold during the periods indicated, they are considered a non-GAAP financial measure. The Company believes sales are a measure of distribution productivity and are a leading indicator of future revenue trends. However, revenues are driven by sales in prior periods as well as in the current period and therefore, a reconciliation of sales to revenues is not meaningful or determinable.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
International:				
Universal life	$ 2,507	1,565	4,151	3,471
Traditional life	1,765	917	3,492	2,136
Equity-indexed life	5,052	4,067	9,779	8,202
	9,324	6,549	17,422	13,809
Domestic:				
Universal life	959	462	1,332	1,157
Traditional life	53	86	128	150
Equity-indexed life	1,433	1,018	2,855	1,426
	2,445	1,566	4,315	2,733
Totals	$ 11,769	8,115	21,737	16,542

Life insurance sales as measured by annualized first year premiums increased 45% in the second quarter of 2007 as compared to the second quarter of 2006 and increased 31% for the first six months of 2007 versus 2006. Both of the Company's life lines of business, international and domestic, posted increases over the comparable results in the second quarter of 2007 with international sales up 42% and domestic sales 56% greater.

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Company management has placed considerable emphasis on building domestic life insurance sales as a strategic focus and in response to comments from outside rating agencies reviewing the Company. Domestic operations have generally focused more heavily on annuity sales than on life insurance sales. The Company spent the greater part of 2003 and 2004 revamping its domestic life operations by changing the way it contracts distribution for life business, eliminating products and distributions that have not contributed significantly to earnings, and creating new and competitive products. A single premium universal life ("SPUL") product was launched at the end of 2003 beginning a diversification of the Company's product portfolio away from smaller dollar face amount policies. The Company released its first equity-indexed universal life ("EIUL") product for its domestic markets at the end of the third quarter of 2005 and began receiving applications. This product accounted for 66% of domestic life insurance sales in the first six months of 2007 and management anticipates this share to continue throughout the remainder of the year. With the introduction of the EIUL and SPUL products and the discontinued marketing of smaller premium and volume life insurance policies, the Company has seen an increase in the average amount of per policy coverage purchased in its domestic markets as shown in the following table:

	Average New Policy Face Amount	
	Domestic	International
Year ended December 31, 2003	$ 76,100	219,600
Year ended December 31, 2004	101,700	234,500
Year ended December 31, 2005	137,900	245,900
Year ended December 31, 2006	315,800	254,700
Six months ended June 30, 2007	342,300	231,300

The Company's international life business consists of applications submitted from residents in various regions outside of the United States, the volume of which typically varies based upon changes in the socioeconomic climates of these regions. Historically, the Company has experienced a simultaneous combination of rising and declining sales in various countries; however, the appeal of the Company's dollar-denominated life insurance products overcomes many of the local and national difficulties. Applications submitted from residents of Latin America and the Pacific Rim perennially have comprised the majority of the Company's international life insurance sales. Over the past few years, effort has been directed toward the sale of a traditional endowment form of life insurance product for residents of Eastern European and the Commonwealth of Independent States (former Soviet Union). More recently, the Company's universal life product offerings have been made available to residents of these countries. While business is still in a formative phase, sales from these countries have gradually become a larger percentage of overall international sales as shown below.

	Six Months Ended June 30,	
	2007	2006
Percentage of International Sales:		
Latin America	63.3%	74.2%
Pacific Rim	14.6	12.1
Eastern Europe	22.1	13.7
Totals	100.0%	100.0%

Year-to-date, the Company has recorded sales to residents outside of the United States in over thirty different countries with Brazil (31%), Taiwan (14%), and Kazakhstan (11%) making up the largest markets.

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The table below sets forth information regarding the Company's life insurance in force for each date presented.

	Insurance In Force as of June 30,	
	2007	2006
	($ in thousands)	
Universal life:		
Number of policies	74,790	77,900
Face amounts	$ 8,015,070	8,022,260
Traditional life:		
Number of policies	52,750	53,920
Face amounts	$ 1,784,330	1,749,140
Equity-indexed life:		
Number of policies	21,740	17,630
Face amounts	$ 4,804,990	3,667,620
Rider face amounts	$ 1,876,600	1,644,710
Total life insurance:		
Number of policies	149,280	149,450
Face amounts	$ 16,480,990	15,083,730

Annuities

The following table sets forth information regarding the Company's annuity sales activity as measured by single and annualized first year premiums. Similar to life insurance sales, these figures are considered a non-GAAP financial measure but are shown in accordance with industry practice and depict the Company's sales productivity.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Equity-indexed annuities	$ 85,584	79,244	154,268	138,766
Other deferred annuities	30,232	47,282	57,889	93,975
Immediate annuities	770	3,671	2,492	7,750
Totals	$ 116,586	130,197	214,649	240,491

Annuity sales for the second quarter of 2007 were 10% lower than the comparable period in 2006 and were 10% lower of the first six months of the year, continuing a trend that began in the first quarter of 2004. Annuity sales in the first quarter of 2004 represented the tail end of the increase in fixed annuity sales that began in 2003 when the Company achieved nearly $1.2 billion in sales. Annuity sales began trending lower due to a combination of declining interest rates, investors returning to alternative investment vehicles and the Company managing its targeted levels of risk and statutory capital and surplus. During the past couple of years interest rate levels have experienced an infrequent occurrence in which the yield curve is inverted, that is, longer term interest rate levels were below shorter term interest rate levels. In such an environment, consumers opt for short term investment vehicles such as bank certificates of deposits rather than longer term choices which include fixed rate annuities.

The Company's mix of annuity sales has shifted the past few years. With a stronger performance in the equity market, sales of equity-indexed annuity products became more prevalent beginning in 2004 and have continued thus far in 2007. Over the past several years sales of equity-indexed products have consistently accounted for more than one-half of all annuity sales and were 72% during the first six months of 2007. For all equity-indexed products, the Company purchases over the counter options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero. The Company does not deliberately mismatch or under hedge for the equity feature of these products.

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The sizable increase in annuity sales volume the past several years has required a greater level of asset/liability analysis. The Company monitors its asset/liability matching within the self-constraints of desired capital levels and risk tolerance. Despite the amounts of new business, the company's capital level remains substantially above industry averages and regulator targets.

The following table sets forth information regarding annuities in force for each date presented.

	Annuities in Force as of June 30,	
	2007	2006
	($ in thousand)	
Equity-indexed annuities		
Number of policies	31,590	28,770
GAAP annuity reserves	$ 1,896,860	1,661,760
Other deferred annuities		
Number of policies	77,280	82,100
GAAP annuity reserves	$ 2,578,700	2,704,690
Immediate annuities		
Number of policies	13,220	12,710
GAAP annuity reserves	$ 251,790	248,780
Total annuities		
Number of policies	122,090	123,580
GAAP annuity reserves	$ 4,727,350	4,615,230

Critical Accounting Estimates

Accounting policies discussed below are those considered critical to an understanding of the Company's financial statements.

Impairment of Investment Securities. The Company's accounting policy requires that a decline in the value of a security below its amortized cost basis be evaluated to determine if the decline is other-than-temporary. The primary factors considered in evaluating whether a decline in value for fixed income and equity securities is other-than-temporary include: (a) the length of time and the extent to which the fair value has been less than cost, (b) the financial conditions and near-term prospects of the issuer, (c) whether the debtor is current on contractually obligated principal and interest payments, and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, certain securitized financial assets with contractual cash flows are evaluated periodically by the Company to update the estimated cash flows over the life of the security. If the Company determines that the fair value of the securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the previous estimate, then an other-than-temporary impairment charge is recognized. When a security is deemed to be impaired a charge is recorded as net realized losses equal to the difference between the fair value and amortized cost basis of the security. Once an impairment charge has been recorded, the fair value of the impaired investment becomes its new cost basis and the Company continues to review the other-than-temporarily impaired security for appropriate valuation on an ongoing basis. Under U.S. generally accepted accounting principles, the Company is not permitted to increase the basis of impaired securities for subsequent recoveries in value.

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Deferred Policy Acquisition Costs ("DAC"). The Company is required to defer certain policy acquisition costs and amortize them over future periods. These costs include commissions and certain other expenses that vary with and are primarily associated with acquiring new business. The deferred costs are recorded as an asset commonly referred to as deferred policy acquisition costs. The DAC asset balance is subsequently charged to income over the lives of the underlying contracts in relation to the anticipated emergence of revenue or profits. Actual revenue or profits can vary from Company estimates resulting in increases or decreases in the rate of amortization. The Company regularly evaluates to determine if actual experience or other evidence suggests that earlier estimates should be revised. Assumptions considered significant include surrender and lapse rates, mortality, expense levels, investment performance, and estimated interest spread. Should actual experience dictate that the Company change its assumptions regarding the emergence of future revenues or profits (commonly referred to as "unlocking"), the Company would record a charge or credit to bring its DAC balance to the level it would have been if using the new assumptions from the inception date of each policy.

DAC is also subject to periodic recoverability and loss recognition testing. These tests ensure that the present value of future contract-related cash flows will support the capitalized DAC balance to be amortized in the future. The present value of these cash flows, less the benefit reserve, is compared with the unamortized DAC balance and if the DAC balance is greater, the deficiency is charged to expense as a component of amortization and the asset balance is reduced to the recoverable amount.

Deferred Sales Inducements. Costs related to sales inducements offered on sales to new customers, principally on investment type contracts and primarily in the form of additional credits to the customer's account value or enhancements to interest credited for a specified period, which are beyond amounts currently being credited to existing contracts, are deferred and recorded as other assets. All other sales inducements are expensed as incurred and included in interest credited to contract holders' funds. Deferred sales inducements are amortized to income using the same methodology and assumptions as DAC, and are included in interest credited to contract holders' funds. Deferred sales inducements are periodically reviewed for recoverability.

Future Policy Benefits. Because of the long-term nature of insurance contracts, the Company is liable for policy benefit payments many years into the future. The liability for future policy benefits represents estimates of the present value of the Company's expected benefit payments, net of the related present value of future net premium collections. For traditional life insurance contracts, this is determined by standard actuarial procedures, using assumptions as to mortality (life expectancy), morbidity (health expectancy), persistency, and interest rates, which are based on the Company's experience with similar products. The assumptions used are those considered to be appropriate at the time the policies are issued. An additional provision is made on most products to allow for possible adverse deviation from the assumptions used. For universal life and annuity products, the Company's liability is the amount of the contract's account balance. Account balances are also subject to minimum liability calculations as a result of minimum guaranteed interest rates in the policies. While management and Company actuaries have used their best judgment in determining the assumptions and in calculating the liability for future policy benefits, there is no assurance that the estimate of the liabilities reflected in the financial statements represents the Company's ultimate obligation. In addition, significantly different assumptions could result in materially different reported amounts.

Revenue Recognition. Premium income for the Company's traditional life insurance contracts is generally recognized as the premium becomes due from policyholders. For annuity and universal life contracts, the amounts collected from policyholders are considered deposits and are not included in revenue. For these contracts, fee income consists of policy charges for policy administration, cost of insurance charges and surrender charges assessed against policyholders' account balances which are recognized in the period the services are provided.

Investment activities of the Company are integral to its insurance operations. Since life insurance benefits may not be paid until many years into the future, the accumulation of cash flows from premium receipts are invested with income reported as revenue when earned. Anticipated yields on investments are reflected in premium rates, contract liabilities, and other product contract features. These anticipated yields are implied in the interest required on the Company's net insurance liabilities (future policy benefits less deferred acquisition costs) and contractual interest obligations in its insurance and annuity products. The Company benefits to the extent actual net investment income exceeds the required interest on net insurance liabilities and manages the rates it credits on its products to maintain the targeted excess or "spread" of investment earnings over interest credited. The Company will continue to be required to provide for future contractual obligations in the event of a decline in investment yield. For more information concerning revenue recognition, investment accounting, and interest sensitivity, please refer to Note 1, Summary of Significant Accounting Policies, and Note 3, Investments, in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and the discussions under Investments in Item 3 of this report.

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Pension Plans and Other Postretirement Benefits. The Company sponsors a qualified defined benefit pension plan covering substantially all employees and three nonqualified defined benefit plans covering certain senior officers. In addition, the Company also has postretirement healthcare benefits for certain senior officers. In accordance with prescribed accounting standards, the Company annually reviews plan assumptions.

The Company annually reviews its pension benefit plan assumptions which include the discount rate, the expected long-term rate of return on plan assets, and the compensation increase rate. The assumed discount rate is set based on the rates of return on high quality long-term fixed income investments currently available and expected to be available during the period to maturity of the pension benefits. The assumed long-term rate of return on plan assets is generally set at the rate expected to be earned based on long-term investment policy of the plans and the various classes of the invested funds, based on the input of the plan's investment advisors and consulting actuary and the plan's historic rate of return. The compensation rate increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation. These assumptions involve uncertainties and judgment and therefore actual performance may not be reflective of the assumptions.

Other postretirement benefit assumptions include future events affecting retirement age, mortality, dependency status, per capita claims costs by age, healthcare trend rates, and discount rates. Per capita claims cost by age is the current cost of providing postretirement healthcare benefits for one year at each age from the youngest age to the oldest age at which plan participants are expected to receive benefits under the plan. Healthcare trend rates involve assumptions about the annual rate(s) of change in the cost of healthcare benefits currently provided by the plan, due to factors other than changes in the composition of the plan population by age and dependency status. These rates implicitly consider estimates of healthcare inflation, changes in utilization, technological advances and changes in health status of the participants. These assumptions involve uncertainties and judgment, and therefore actual performance may not be reflective of the assumptions.

Other significant accounting policies, although not involving the same level of measurement uncertainties as those discussed above but nonetheless important to an understanding of the financial statements, are described in the Company's annual report on Form 10-K for the year ended December 31, 2006.

RESULTS OF OPERATIONS

The Company's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). In addition, the Company regularly evaluates operating performance using non-GAAP financial measures which exclude or segregate derivatives and realized investment gains and losses from operating revenues and earnings. Similar measures are commonly used in the insurance industry in order to assess profitability and results from ongoing operations. The Company believes that the presentation of these non-GAAP financial measures enhances the understanding of the Company's results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Company's business. The Company excludes or segregates derivatives and realized investment gains and losses because such items are often the result of events which may or may not be at the Company's discretion and the fluctuating effects of these items could distort trends in the underlying profitability of the Company's business. Therefore, in the following sections discussing consolidated operations and segment operations appropriate reconciliations have been included to report information management considers useful in enhancing an understanding of the Company's operations to reportable GAAP balances reflected in the consolidated financial statements.

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Consolidated Operations

Revenues. The following details Company revenues.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Traditional life and annuity premiums	$ 4,586	4,097	9,319	8,088
Universal life and annuity contract revenues	28,653	25,598	57,449	52,554
Net investment income (excluding derivatives)	84,653	83,651	166,274	167,162
Other income	3,359	3,009	6,675	8,207
Operating revenues	121,251	116,355	239,717	236,011
Derivative income (loss)	23,279	(17,328)	18,684	(2,152)
Realized gains on investments	4,165	1,616	4,406	3,039
Total revenues	$ 148,695	100,643	262,807	236,898

Traditional life and annuity premiums - Traditional life and annuity premiums increased 11.9% and 15.2% for the three and six months ended June 30, 2007 compared to the same period in 2006. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period.

Universal life and annuity contract revenues - Revenues for universal life and annuity contract revenues increased 11.9% for the three months ended June 30, 2007 and 9.3% for the first six months of the current year compared to 2006 and consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances. Revenues in the form of cost of insurance charges were $18.2 million and $36.1 million for the three and six months of 2007 compared to $16.6 million and $33.1 million for the three and six months ended June 30, 2006. Surrender charges assessed against policyholder account balances upon withdrawal increased to $8.3 million and $15.9 million for the three and six months of 2007 versus $7.0 million and $14.7 million for the three and six months ended June 30, 2006.

Net investment income - A detail of net investment income is provided below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Gross investment income:				
Debt securities	$ 77,259	76,989	153,575	153,114
Mortgage loans	2,126	2,038	4,334	4,676
Policy loans	1,471	1,567	3,116	3,147
Short-term investments	1,776	348	3,662	610
Other invested assets	2,774	3,189	3,009	7,111

Total investment income		85,406	84,131	167,696	168,658
Investment expenses		753	480	1,422	1,496
Net investment income (excluding derivatives)		84,653	83,651	166,274	167,162
Derivative income (loss)		23,279	(17,328)	18,684	(2,152)
Net investment income	$	107,932	66,323	184,958	165,010

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Short-term investments contributed $1.8 million and $3.7 million to income for the three months and six months ended June 30, 2007 compared to $0.3 million and $0.6 million for the same period in 2006. This increase in 2007 is attributable to higher asset holdings in these investments compared to 2006. Income from other invested assets for the six months ended June 30, 2006 includes a profit participation interest of $1.6 million and residual profits of $1.1 million from the sale of equity loans contributing to higher income year to date. Derivative gains and losses are recorded as a component of investment income but may fluctuate substantially from period to period based on the performance of the S&P 500® Composite Stock Price Index ("S&P 500 Index®"). See the discussion that follows this section relating to index options and derivatives.

To ensure the Company will be able to pay future commitments to policyholders and provide a financial return, the funds received as premium payments and deposits are invested in high quality investments, primarily debt securities. The income from these investments is closely monitored by the Company due to its significant impact on the business.

Net investment income performance is summarized as follows:

	Six Months Ended June 30,	
	2007	2006
	(In thousands)	
Excluding derivatives:		
Net investment income	$ 166,274	167,162
Average invested assets, at amortized cost	$ 5,686,309	5,453,706
Annual yield on average invested assets	5.85%	6.13%
Including derivatives:		
Net investment income	$ 184,958	165,010
Average invested assets, at amortized cost	$ 5,741,074	5,493,256
Annual yield on average invested assets	6.44%	6.01%

The yield on average invested assets decreased from 6.13% in 2006 to 5.85% in 2007, excluding derivatives. The higher yield in 2006 compared to 2007 is due to the additional income recognized from the other invested assets of $2.7 million as previously described. Net investment income performance is analyzed excluding the derivative income which is a common practice in the insurance industry in order to assess underlying profitability and results from ongoing operations.

Derivative income (loss) - Index options are derivative financial instruments used to fully hedge the equity return component of the Company's equity-indexed products. Index options are intended to act as hedges to match closely the returns on the S&P 500 Index®. With an increase or decline in this index, the index option values likewise increase or decline. Any income or loss from the sale or expiration of the options, as well as period-to-period changes in fair values, are reflected as a component of net investment income. However, increases or decreases in income from these options are substantially offset by corresponding increases or decreases in amounts credited to equity-indexed annuity and life policyholders.

Derivative components included in net investment income and the corresponding contract interest amounts are detailed below for each date presented.

	Three Months Ended June 30,	Six Months Ended June 30,

	2007	2006	2007	2006
		(In thousands)		
Derivatives:				
Unrealized income (loss)	$ 9,951	(22,919)	1,361	(6,905)
Realized income	13,328	5,591	17,323	4,753
Total income (loss) included in net investment income	$ 23,279	(17,328)	18,684	(2,152)
Total contract interest	$ 67,385	23,565	104,818	79,613

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Other income - Other income primarily pertains to the Company's operations involving a nursing home. Revenues associated with this operation were $6.2 million and $5.3 million for the six months ended June 30, 2007 and 2006, respectively. In addition, included in other income for the six months ended June 30, 2006 is $2.6 million resulting from partial lawsuit settlements.

Realized gains on investments - Realized investment gains of $4.2 million and $1.6 million were recorded in the second quarter of 2007 and 2006, respectively. In the second quarter of 2007, the gain of $3.7 million results from a sale of a previously impaired bond. The gains in 2006 are primarily due to sales of collateralized bond obligation holdings from the debt securities portfolio which had previously been impaired.

Benefits and Expenses. The following details benefits and expenses.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Life and other policy benefits	$	10,437	7,646	21,411	19,088
Amortization of deferred policy acquisition costs		25,637	22,715	49,422	45,013
Universal life and annuity contract interest		67,385	23,565	104,818	79,613
Other operating expenses		16,367	13,724	30,483	39,098
Totals	$	119,826	67,650	206,134	182,812

Life and other policy benefits - Death claims increased from $5.3 million and $14.2 million during the three and six months of the second quarter of 2006 to $7.9 million and $15.6 million for the same period ended June 30, 2007. While death claim amounts are subject to variation from period to period, the Company's mortality experience has generally been consistent with its product pricing assumptions.

Amortization of deferred acquisition costs - Life insurance companies are required to defer certain expenses associated with acquiring new business. The majority of these acquisition expenses consist of commissions paid to agents, underwriting costs, and certain marketing expenses and sales inducements. The Company defers sales inducements in the form of first year interest bonuses on annuity and universal life products that are directly related to the production of new business. These charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. Recognition of these deferred policy acquisition costs in the financial statements occurs over future periods in relation to the emergence of profits priced into the products sold. This emergence of profits is based upon assumptions regarding premium payment patterns, mortality, persistency, investment performance, and expense patterns. Companies are required to review these assumptions periodically to ascertain whether actual experience has deviated significantly from that assumed. If it is determined that a significant deviation has occurred, the emergence of profits pattern is to be "unlocked" and reset based upon the actual experience. While the Company is required to evaluate its emergence of profits continually, management believes that the current amortization patterns of deferred policy acquisition costs are reflective of actual experience.

Amortization of deferred policy acquisition costs increased to $25.6 million and $49.4 million for the three and six months of the second quarter of 2007 compared to $22.7 million and $45.0 million reported in 2006. In accordance with the newly adopted SOP 05-1, the Company’s amortization of these deferred costs is expected to increase in the future. Under this pronouncement, annuitizations and certain internal replacements of contracts result in the associated unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets being written off.

Universal life and annuity contract interest - The Company closely monitors its credited interest rates on interest sensitive policies, taking into consideration such factors as profitability goals, policyholder benefits, product marketability, and economic market conditions. As long term interest rates change, the Company's credited interest rates are often adjusted accordingly, taking into consideration the factors as described above. The difference between yields earned over policy credited rates is often referred to as the "interest spread". Raising policy credited rates can typically have more of an immediate impact than higher market rates on the Company's investment portfolio yield, making it more difficult to maintain the current interest spread.

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The Company's approximated average credited rates are as follows:

	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
	(Excluding derivative products)		(Including derivative products)	
Annuity	3.38%	3.39%	3.69%	2.87%
Interest sensitive life	3.16%	4.73%	5.13%	4.38%

Contract interest also includes the performance of the equity-index component of the Company's derivative products as noted which resulted in income of $23.3 million and $18.7 million and losses of $17.3 million and $2.2 million for the three and six months ended June 30, 2007 and 2006, respectively. As previously noted, the recent market performance of these equity-index features is included in contract interest expense while also impacting the Company's investment income given the hedge nature of the options purchased for these products.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, and commissions not subject to deferral. Like revenues from other income, nursing home operation expenses are included in other operating expenses in the amount of $2.8 million and $5.4 million for the three and six months ended June 30, 2007 and $2.6 million and $4.9 million for the same period in 2006. Compensation cost recorded in the three and six months ended June 30, 2007 totaled $1.3 million and $2.6 million. Other operating expenses for the three and six months ended June 30, 2006 also includes compensation cost of $1.4 million and $13.9 million as a result of implementation of liability classification under SFAS 123(R) for the Company's stock option plan. Implementation of liability classification resulted in a current charge for option costs related to outstanding vested and unvested options.

Federal Income Taxes. Federal income taxes on earnings from continuing operations reflect effective tax rates of 28.5% and 32.9% for the first six months of 2007 and 2006, respectively. The effective tax rate is lower than the Federal rate of 35% primarily due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks.

During the second quarter of 2007, upon the completion of a detailed review of the deferred tax items, the Company identified a $2.3 million error in the net deferred tax liability. The error, which occurred during various periods prior to 2005, was corrected in the second quarter of 2007 and resulted in a decrease in the net deferred tax liability and deferred tax expense. The adjustment was not material to the current period or any prior period financial statements.

Segment Operations

Summary of Segment Earnings

A summary of segment earnings for the three months and six months ended June 30, 2007 and 2006 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Segment earnings (losses):					
Three months ended:					

June 30, 2007	$	961	772	15,014	2,397	19,144
June 30, 2006	$	796	5,726	12,685	1,970	21,177
Six months ended:						
June 30, 2007	$	(391)	4,853	29,961	3,236	37,659
June 30, 2006	$	(1,104)	7,086	25,874	2,441	34,297

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Domestic Life Insurance Operations

A comparative analysis of results of operations for the Company's domestic life insurance segment is detailed below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Premiums and other revenue:				
Premiums and contract revenues	$ 6,314	5,699	12,647	11,533
Net investment income	4,515	5,020	9,193	10,216
Other income	13	7	27	15
Total premiums and other revenue	10,842	10,726	21,867	21,764
Benefits and expenses:				
Life and other policy benefits	2,617	3,077	8,758	8,031
Amortization of deferred policy acquisition costs	2,324	1,971	4,188	3,372
Universal life insurance contract interest	2,312	2,273	4,632	4,543
Other operating expenses	2,119	2,200	4,831	7,462
Total benefits and expenses	9,372	9,521	22,409	23,408
Segment earnings (losses) before Federal income taxes	1,470	1,205	(542)	(1,644)
Provision (benefit) for Federal income taxes	509	409	(151)	(540)
Segment earnings (losses)	$ 961	796	(391)	(1,104)

Revenues from domestic life insurance operations include life insurance premiums on traditional type products and revenues from universal life insurance. Revenues from traditional products are simply premiums collected, while revenues from universal life insurance consist of policy charges for the cost of insurance, policy administration fees, and surrender charges assessed during the period. A comparative detail of premiums and contract revenues is provided below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Universal life insurance revenues	$ 5,225	4,189	10,415	8,657
Traditional life insurance premiums	1,924	1,921	3,636	3,669
Reinsurance premiums	(835)	(411)	(1,404)	(793)

Totals	$	6,314	5,699	12,647	11,533

The Company's U.S. operations have typically emphasized annuity product sales over life product sales but recent efforts have been made to attract new independent agents and to promote life products to improve domestic sales. It is the Company's goal to increase domestic life product sales through increased recruiting of new distribution and the development of new life insurance products. The Company had approximately 6,500 contracted agents as of June 30, 2007.

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Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Universal life insurance:					
First year and single premiums	$	3,530	2,347	6,371	6,219
Renewal premiums		3,881	3,416	8,058	7,008
Totals	$	7,411	5,763	14,429	13,227

Other operating expenses were $4.8 million and $7.5 million for the six months ended June 30, 2007 and 2006. An additional expense related to compensation costs in 2006 resulted from the implementation of liability classification under SFAS 123(R).

International Life Insurance Operations

A comparative analysis of results of operations for the Company's international life insurance segment is detailed below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Premiums and other revenue:					
Premiums and contract revenues	$	20,564	18,700	42,235	38,084
Net investment income		8,853	5,173	14,615	12,187
Other income		42	22	87	45
Total premiums and other revenue		29,459	23,895	56,937	50,316
Benefits and expenses:					
Life and other policy benefits		7,300	3,839	10,977	9,220
Amortization of deferred policy acquisition costs		7,817	4,570	15,980	9,511
Universal life insurance contract interest		7,844	3,273	13,096	9,214
Other operating expenses		5,838	3,707	10,148	11,825
Total benefits and expenses		28,799	15,389	50,201	39,770
Segment earnings before Federal income taxes		660	8,506	6,736	10,546
Provision (benefit) for Federal					

income taxes		(112)	2,780	1,883	3,460
Segment earnings	$	772	5,726	4,853	7,086

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As with domestic operations, revenues from the international life insurance segment include both premiums on traditional type products and revenues from universal life insurance. A comparative detail of premiums and contract revenues is provided below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Universal life insurance revenues	$	20,970	18,999	41,657	38,436
Traditional life insurance premiums		3,396	2,715	6,973	5,461
Reinsurance premiums		(3,802)	(3,014)	(6,395)	(5,813)
Totals	$	20,564	18,700	42,235	38,084

International operations have emphasized universal life policies over traditional life insurance products. Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Universal life insurance:					
First year and single premiums	$	10,769	8,393	19,698	16,932
Renewal premiums		22,431	19,493	42,934	38,502
Totals	$	33,200	27,886	62,632	55,434

The Company's international life operations have been a significant part of the Company's business which is based upon a long standing reputation in the international market. The Company reported increased sales of equity-indexed universal life products for international life operations with premiums approximating $18.3 million and $34.3 million for the three and six months ended June 30, 2007 and $14.0 million and $26.7 million for the same periods in 2006. As previously noted, net investment income and contract interest include an increase due to the S&P 500 Index® performance relative to equity-indexed products in the three and six months of 2007 compared to the same period in 2006.

A detail of net investment income for international life insurance operations is provided below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Net investment income (excluding derivatives)	$	6,684	6,232	12,970	12,554
Derivative income (loss)		2,169	(1,059)	1,645	(367)

Net investment income	$ 8,853	5,173	14,615	12,187

Amortization of deferred policy acquisition costs increased approximately 68% comparing the first six months of 2007 to the same period in 2006. This increase is due primarily to the application of SOP 05-1 as previously discussed. Amortization expense increases due to the requirement to write-off deferred balances on contracts that are considered substantially changed under this new guidance. The balances were previously carried and amortized over the projected life of the contract.

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Other operating expenses were $10.1 million and $11.8 million for the six months ended June 30, 2007 and 2006. An additional expense in 2006 resulted from an increase in compensation costs under SFAS 123(R) as a result of the implementation of liability classification for stock options.

Annuity Operations

The Company's annuity operations are almost exclusively in the United States. Although some of the Company's investment contracts are available to international residents, current sales are small relative to total annuity sales. A comparative analysis of results of operations for the Company's annuity segment is detailed below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Premiums and other revenue:				
Premiums and contract revenues	$ 6,361	5,296	11,886	11,025
Net investment income	91,677	53,409	157,430	139,407
Other income	138	155	366	2,862
Total premiums and other revenue	98,176	58,860	169,682	153,294
Benefits and expenses:				
Life and other benefits	520	730	1,676	1,837
Amortization of deferred policy acquisition costs	15,496	16,174	29,254	32,130
Annuity contract interest	57,229	18,019	87,090	65,856
Other operating expenses	5,599	5,199	10,080	14,960
Total benefits and expenses	78,844	40,122	128,100	114,783
Segment earnings before Federal income taxes	19,332	18,738	41,582	38,511
Provision for Federal income taxes	4,318	6,053	11,621	12,637
Segment earnings	$ 15,014	12,685	29,961	25,874

Revenues from annuity operations primarily include surrender charges and recognition of deferred revenues relating to immediate or payout annuities. A comparative detail of the components of premiums and annuity contract revenues is provided below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Surrender charges	$ 5,342	4,307	9,734	8,856
Payout annuity and other revenues	1,013	982	2,139	2,155

Traditional annuity premiums		6	7	13	14
Totals	$	6,361	5,296	11,886	11,025

The Company's earnings are dependent upon annuity contracts persisting or remaining in force. While premium and contract revenues decline with a reduction in surrender charges, the Company's investment earnings benefit as more policies remain in force.

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Deposits collected on annuity contracts are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual annuity deposits collected for the six months ended June 30, 2007 and 2006 are detailed below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Equity-indexed annuities	$	88,551	82,651	152,004	146,991
Other deferred annuities		29,344	47,532	62,030	93,541
Immediate annuities		627	3,261	2,401	6,261
Totals	$	118,522	133,444	216,435	246,793

Sales of equity-indexed annuities increased 7.1% and 3.4% comparing June 30, 2006 quarter end three and six months deposits collected to the same period of 2007. Equity-indexed product sales typically follow the stock market in that sales are higher when confidence is high in the stock market and low if the stock market is showing poor performance. Since the Company does not offer variable products or mutual funds, these equity-indexed products provide an interest crediting alternative to the Company's existing fixed annuity products and have continued to be a significant portion of the Company's annuity business.

Other deferred annuity deposits decreased during the quarter ended June 30, 2007 versus June 30, 2006 with $29.3 million and $62.0 million collected as compared to $47.5 million and $93.5 million for the three and six months, respectively. These product sales have been trending lower over the past few years due to low interest rates and investor preferences. As a selling inducement, many of the deferred products include a first year interest bonus in addition to a base interest rate. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amount deferred and amortized over future periods amounted to approximately $5.9 million and $10.1 million for the three and six months ended June 30, 2007 and $6.0 million and $10.7 million in 2006, respectively.

A detail of net investment income for annuity operations is provided below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Net investment income (excluding derivatives)	$	70,566	69,678	140,390	141,192
Derivative income (loss)		21,111	(16,269)	17,040	(1,785)
Net investment income	$	91,677	53,409	157,430	139,407

Derivative income and loss fluctuate from period to period based on the S&P 500 Index® performance.

Other income reported for the six months ended June 30, 2006 includes $2.6 million relating to lawsuit settlements.

The Company is required to periodically adjust deferred policy acquisition amortization factors for actual experience that varies from assumptions. In the first quarter of 2006, a true-up of assumptions based upon actual results increased amortization for the six months ended June 30.

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Annuity contract interest includes any equity component interest associated with the Company's equity-indexed annuities. The detail of equity-indexed annuity contract interest compared to contract interest for all other annuities is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Equity-indexed annuities	$ 35,919	(901)	43,760	20,584
All other annuities	23,965	22,187	47,822	50,969
Gross contract interest	59,884	21,286	91,582	71,553
Bonus interest deferred and capitalized	(5,928)	(5,978)	(10,093)	(10,699)
Bonus interest amortization	3,273	2,711	5,601	5,002
Total contract interest	$ 57,229	18,019	87,090	65,856

As previously noted, contract interest reflects an increase due to the S&P 500 Index® performance relative to equity-indexed products, increasing in the three and six months of 2007 compared to the same period in 2006.

Other operating expenses were $10.1 million and $15.0 million during the six months ended June 30, 2007 and 2006, respectively. An additional expense in 2006 resulted from implementing liability classification related to the Company's stock option plan under SFAS 123(R) accounting guidance.

Other Operations

National Western's primary business encompasses its domestic and international life insurance operations and its annuity operations. However, National Western also has small real estate, nursing home, and other investment operations through its wholly-owned subsidiaries. Nursing home operations generated $0.8 million and $0.4 million of operating earnings in the first six months of 2007 and 2006, respectively.

INVESTMENTS

General

The Company's investment philosophy emphasizes the prudent handling of policyowners' and stockholders' funds to achieve security of principal, to obtain the maximum possible yield while maintaining security of principal, and to maintain liquidity in a measure consistent with current and long-term requirements of the Company.

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The Company's overall conservative investment philosophy is reflected in the allocation of its investments, which is detailed below as of June 30, 2007 and December 31, 2006. The Company emphasizes investment grade debt securities, with smaller holdings in mortgage loans and policy loans.

	Composition of Investments			
	June 30, 2007		December 31, 2006	
	Amount (In thousands)	%	Amount (In thousands)	%
Debt securities	$ 5,554,892	94.8	$ 5,484,799	94.7
Mortgage loans	104,085	1.8	103,325	1.8
Policy loans	85,279	1.4	86,856	1.5
Derivatives	74,886	1.3	72,012	1.2
Equity securities	21,186	0.4	21,203	0.4
Real estate	12,115	0.2	12,113	0.2
Other	9,489	0.1	10,709	0.2
Totals	$ 5,861,932	100.0	$ 5,791,017	100.0

Debt and Equity Securities

The Company maintains a diversified portfolio which consists primarily of corporate, mortgage-backed, and public utilities fixed income securities. Investments in mortgage-backed securities include primarily U.S. government agency pass-through securities and collateralized mortgage obligations ("CMOs"). As of June 30, 2007 and December 31, 2006, the Company's debt securities portfolio consisted of the following:

	Composition of Debt Securities			
	June 30, 2007		December 31, 2006	
	Amount (In thousands)	%	Amount (In thousands)	%
Corporate	$ 2,413,406	43.5	$ 2,384,762	43.5
Mortgage-backed securities	1,878,036	33.8	1,817,532	33.1
Public utilities	631,296	11.4	623,649	11.4
U.S. government/agencies	427,911	7.7	447,573	8.2
Asset-backed securities	113,571	2.0	122,101	2.2
States & political subdivisions	60,293	1.1	58,627	1.1
Foreign governments	30,379	0.5	30,555	0.5
Totals	$ 5,554,892	100.0	$ 5,484,799	100.0

The Company has expanded its holdings of U.S. government and private mortgage-backed securities over the past several years given attractive yields and spreads. Because the Company's holdings of mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing primarily in collateralized mortgage obligations, which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I") and sequential tranches are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

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Within the debt securities portfolio, the Company holds approximately $113.6 million in asset-backed securities at June 30, 2007, which include manufactured housing bonds and home equity loans. The Company does not have any holdings in collaterized bond obligations (CBOs), collateralized debt obligations (CDOs), or collateralized loan obligations (CLOs). Principal risks in holding asset-backed securities are structural, credit and capital market risks. Structural risks include the securities' priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from collateral and the potential for prepayments. Credit risks include corporate credit risks or consumer credit risks for financing such as subprime mortgages. Capital market risks include the general level of interest rates and the liquidity for these securities in the marketplace. As of June 30, 2007, the Company held investments in asset-backed securities collateralized by subprime mortgages with a carrying value of $56.0 million, less than 1% of invested assets. None of these securities are rated below "AAA" and over 50% are insured. In addition, all of the subprime related asset-backed securities were purchased prior to 2005, the commencement of the period during which management believes the quality of underwriting was lessened. In light of the high credit quality of these securities, the Company does not expect to incur any material losses despite the recent increase in default rates and market concern over future performance of this asset class. The Company also does not have investments in bond funds with subprime exposure.

In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investments in debt securities. As of June 30, 2007, 98.1% of the Company's debt securities were investment grade quality. Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's portfolio. In addition, the Company is monitoring the bond portfolio in reference to the possibility of leveraged buyouts that would likely result in lower credit quality ratings. In the table below, investments in debt securities are classified according to credit ratings by Standard and Poor's ("S&P®"), or other nationally recognized statistical rating organizations if securities were not rated by S&P® .

	June 30, 2007		December 31, 2006	
	Amount (In thousands)	%	Amount (In thousands)	%
AAA and U.S. government	$ 2,541,248	45.8	$ 2,485,122	45.3
AA	300,107	5.4	284,965	5.2
A	1,362,937	24.5	1,330,980	24.3
BBB	1,243,019	22.4	1,237,151	22.5
BB and other below investment grade	107,581	1.9	146,581	2.7
Totals	$ 5,554,892	100.0	$ 5,484,799	100.0

The Company does not purchase below investment grade securities. Investments held in debt securities below investment grade are the result of subsequent downgrades of the securities. During the first six months of 2007, the Company's percentage of below investment grade securities decreased from 2.7% of the portfolio to 1.9%. The Company's holdings of below investment grade securities as a percentage of total invested assets is relatively small compared to industry averages. These holdings are summarized below.

	Below Investment Grade Debt Securities			
	Amortized Cost	Carrying Value	Estimated Fair Value	% of Invested Assets
	(In thousands except percentages)			

June 30, 2007	$	108,724	107,581	106,648	1.8%
December 31, 2006	$	145,858	146,581	146,170	2.5%
December 31, 2005	$	168,423	170,455	167,770	3.1%

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The Company closely monitors its other below investment grade holdings by reviewing investment performance indicators including information such as issuer operating performance, debt ratings, analyst reports and other economic factors that may affect these specific investments. While additional losses are not currently anticipated based on the existing status and condition of these securities, continued credit deterioration of some securities is possible, which may result in further writedowns. Holdings in below investment grade securities by category are summarized below.

	Below Investment Grade Debt Securities as of June 30, 2007			
	Amortized Cost 2007	Carrying Value 2007	Fair Value 2007	Fair Value 2006
	(In thousands)			
Retail	$ 28,966	29,066	28,961	29,002
Utilities/Energy	21,452	22,750	22,922	23,259
Telecommunication	19,997	18,072	18,072	17,999
Asset-backed	11,885	11,885	11,115	11,256
Auto finance	6,160	6,160	5,922	6,200
Manufacturing	5,491	5,491	5,499	5,466
Transportation	2,288	3,013	3,013	3,136
Other	12,485	11,144	11,144	10,467
Totals	$ 108,724	107,581	106,648	106,785

The Company is required to classify its investments in debt and equity securities into one of three categories: (a) trading securities, (b) securities available for sale, or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, at June 30, 2007, approximately 34% of the Company's total debt and equity securities, based on fair values, were classified as securities available for sale. This slight increase in available for sale securities is a result of short-term investments in bonds. These holdings provide the Company flexibility to react to market opportunities and conditions and to practice active management within the portfolio to provide adequate liquidity to meet policyholder obligations and other cash needs.

	Fair Value	Amortized Cost	Unrealized Gains (Losses)
		(In thousands)	
Securities held to maturity:			
Debt securities	$ 3,612,794	3,708,513	(95,719)
Securities available for sale:			
Debt securities	1,846,379	1,889,861	(43,482)
Equity securities	21,186	12,054	9,132
Totals	$ 5,480,359	5,610,428	(130,069)

In accordance with SFAS No. 115, *Accounting for Certain Debt and Equity Securities,* during the first six months of 2007 one security was sold from the held to maturity portfolio due to significant credit deterioration. The amortized cost of the bond was $5.2 million and resulted in a realized gain of $19,000. No securities were sold during the first six months of 2006. No securities were transferred from the held to maturity portfolio during the first six months of 2007 or 2006.

Proceeds from sales of securities available for sale totaled $11.4 million and $12.0 million during the second quarter of 2007 and 2006, respectively, which resulted in realized gains of $4.1 million in 2007 and realized gains of $0.3 million in 2006. For the six months ended June 30, 2007 and 2006, proceeds from sales of securities available for sale totaled $11.6 million and $21.4 million, respectively. These sales resulted in gains of $4.4 million and $1.7 million, respectively.

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Market Risk

Market risk is the risk of change in market values of financial instruments due to changes in interest rates, currency exchange rates, commodity prices, or equity prices. The most significant market risk exposure for National Western is interest rate risk. The fair values of fixed income debt securities correlate to external market interest rate conditions. Because interest rates are fixed on almost all of the Company's debt securities, market values typically increase when market interest rates decline, and decrease when market interest rates rise. However, market values may fluctuate for other reasons, such as changing economic conditions or increasing event-risk concerns.

The correlation between fair values and interest rates for debt securities is reflected in the tables below.

	June 30, 2007	March 31, 2007	December 31, 2006
	(In thousands except percentages)		
Debt securities - fair value	$ 5,459,172	5,532,614	5,448,990
Debt securities - amortized cost	$ 5,598,374	5,551,182	5,498,461
Fair value as a percentage of amortized cost	97.51%	99.67%	99.10%
Unrealized losses	$ (139,201)	(18,568)	(49,471)
Ten-year U.S. Treasury bond – increase (decrease) in yield for the quarter	0.38%	(0.06)%	

	Unrealized Losses Balance				
	At June 30, 2007	At March 31, 2007	At December 31, 2006	Qtr Change in Unrealized Losses	YTD Change in Unrealized Losses
Debt securities held to maturity	$ (95,719)	(15,784)	(35,809)	(79,935)	(59,910)
Debt securities available for sale	(43,482)	(2,784)	(13,662)	(40,698)	(29,820)
Totals	$ (139,201)	(18,568)	(49,471)	(120,633)	(89,730)

Changes in interest rates typically have a significant impact on the fair values of the Company's debt securities. Market interest rates of the ten-year U.S. Treasury bond increased approximately 38 basis points from the first quarter of 2007, increasing the unrealized loss to $139.2 million on a portfolio of approximately $5.5 billion. The Company would expect similar results in the future from any significant upward or downward movement in market rates. However, since the majority of the Company's debt securities are classified as held to maturity, which are recorded at amortized cost, as the Company has the ability and intent to hold these securities, changes in fair values due to interest rate risk have relatively small effects on the Company's consolidated balance sheet.

The Company manages interest rate risk through on-going cash flow testing required for insurance regulatory purposes. Computer models are used to perform cash flow testing under various commonly used stress test interest rate scenarios to determine if existing assets would be sufficient to meet projected liability outflows. Sensitivity analysis allows the Company to measure the potential gain or loss in fair value of its interest-sensitive instruments and to protect its economic value and achieve a predictable spread between what is earned on invested assets and what is paid on liabilities. The Company seeks to minimize the impact of interest risk through surrender charges that are imposed to discourage policy surrenders. Interest rate changes can be anticipated in the computer models and the corresponding risk addressed by management actions affecting asset and liability instruments. However, potential changes in the values of financial instruments indicated by hypothetical interest rate changes will likely be different from actual changes experienced, and the differences could be significant.

The Company performed detailed sensitivity analysis as of December 31, 2006, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities in the second quarter of 2007 were reasonable given the expected range of results of this analysis.

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and revenues, investment income, and investment maturities are the primary sources of funds while investment purchases, policy benefits, and operating expenses are the primary uses of funds. The Company historically has not been put in the position of liquidating invested assets to provide cash flow. However, investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. The Company may also borrow up to $40 million on its bank line of credit for short-term cash needs.

A primary liquidity concern for life insurers is the risk of an extraordinary level of early policyholder withdrawals. The Company includes provisions within its annuity and universal life insurance policies, such as surrender charges, that help limit and discourage early withdrawals.

The actual amounts paid by product line in connection with surrenders and withdrawals for the periods ended June 30 are noted in the table below.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2007	2006	2007	2006
		(In thousands)			
Product Line:					
Traditional Life	$	1,727	1,142	2,717	2,057
Universal Life		8,020	8,491	16,067	15,509
Annuities		123,151	91,055	215,130	181,587
Total	$	132,898	100,688	233,914	199,153

The above contractual withdrawals, as well as the level of surrenders experienced, were generally consistent with the Company's assumptions in asset/liability management, and the associated cash outflows did not have an adverse impact on overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Cash flow projections and tests under various market interest rate scenarios are also performed to assist in evaluating liquidity needs and adequacy. The Company currently expects available liquidity sources and future cash flows to be more than adequate to meet the demand for funds.

In the past, cash flows from the Company's insurance operations have been sufficient to meet current needs. Cash flows from operating activities were $118.1 million and $110.8 billion for the six months ended June 30, 2007 and 2006, respectively. The Company also has significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled $268.8 million and $158.4 million for the six months ended June 30, 2007 and 2006, respectively. These cash flow items could be reduced if interest rates rise. Net cash inflows (outflows) from the Company's universal life and investment annuity deposit product operations totaled ($51.8) million and $8.7 million during the six months ended June 30, 2007 and 2006, respectively.

Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of June 30, 2007, the Company had commitments of approximately $7.3 million remaining to be funded of a $10.0 million commitment which was approved by the Company's Board of Directors for the construction of a nursing home facility in Central Texas. The construction of the new facility began in 2007.

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OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

It is not Company practice to enter into off-balance sheet arrangements nor is it Company policy to issue guarantees to third parties, other than in the normal course of issuing insurance contracts. Commitments related to insurance products sold are reflected as liabilities for future policy benefits. Insurance contracts guarantee certain performances by the Company.

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note (1) in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for a discussion of reserving methods.

The table below summarizes future estimated cash payments under existing contractual obligations.

		Payment Due by Period				
			Less Than	1 - 3	3 - 5	More Than
		Total	1 Year	Years	Years	5 Years
				(In thousands)		
Operating lease obligations (1)	$	2,325	808	1,300	217	-
Loan commitments		9,785	9,785	-	-	-
Life claims payable (2)		52,672	52,672	-	-	-
Other long-term reserve liabilities reflected on the balance sheet under GAAP (3)		370,453	72,988	108,289	55,158	134,018
Total	$	435,235	136,253	109,589	55,375	134,018

(1) Refer to Note 9 in the Notes to Consolidated Financial Statements relating to leases in the Company's Annual Report on Form 10-K.
(2) Life claims payable include benefit and claim liabilities for which the Company believes the amount and timing of the payment is essentially fixed and determinable. Such amounts generally relate to incurred and reported death and critical illness claims including an estimate of claims incurred but not reported.
(3) Other long-term reserve liabilities include obligations that are reported within the Company's reserve liabilities that reflect determinable payout patterns related to immediate annuities. The above amounts are undiscounted whereas the amounts included in future policy benefit liabilities are discounted in accordance with GAAP. Liabilities for future policy benefits and other policyholder liabilities of approximately $5.2 billion as of June 30, 2007 have been excluded from the contractual obligations table. These excluded liabilities include future policy benefits relating to life insurance products, deferred annuities, and universal life products. Amounts excluded from the table are comprised of policies or contracts where (a) the Company is not currently making payments and will not make payments in the future until the occurrence of a payment triggering event, such as death or (b) the occurrence of a payment triggering event, such as a surrender of a policy or contract, which is outside of the control of the Company. The timing of these payments is not reasonably fixed and determinable. These uncertainties are considered in the Company's asset/liability management program as previously noted.

CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

Changes in Accounting Principles

Refer to Note 2 of the Notes to Condensed Consolidated Financial Statements.

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REGULATORY AND OTHER ISSUES

Statutory Accounting Practices

Regulations that affect the Company and the insurance industry are often the result of efforts by the National Association of Insurance Commissioners ("NAIC"). The NAIC routinely publishes new regulations as model acts or laws which states subsequently adopt as part of their insurance regulations. Currently, the Company is not aware of any NAIC regulatory matter material to its operations or reporting of financial results.

Risk-Based Capital Requirements

The NAIC established risk-based capital ("RBC") requirements to help state regulators monitor the financial strength and stability of life insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk which are: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses mortality and morbidity risk; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks. Statutory laws prohibit public dissemination of certain RBC information. However, the Company's current statutory capital and surplus is significantly in excess of the threshold RBC requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This information is included in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Investments in Debt and Equity Securities section.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Finanical Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There have been no changes in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 9 "Legal Proceedings" of the accompanying financial statements included in this Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Effective March 10, 2006, the Company adopted and implemented a limited stock buy-back program associated with the Company's 1995 Stock Option and Incentive Plan ("Plan") which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option Holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election.

During the months ended in May and June 2007, the Company purchased 3,710 shares and 2,830 shares from option holders at an average price of $260.88 and $253.71, respectively. These purchased shares are reported in the Company's condensed consolidated financial statements as authorized and unissued.

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

On June 15, 2007, the stockholders voted upon the following matters at the annual stockholders meeting:

(a) The election of Class A directors to the Company's Board of Directors to serve one-year terms. The results of the voting were as follows:

	For	Against
Robert L. Moody	2,853,335	332,172
Harry L. Edwards	2,844,923	340,584
Stephen E. Glasgow	2,896,940	288,567
E.J. Pederson	2,897,068	288,439

(b) The election of Class B directors to the Company's Board of Directors to serve one-year terms. The results of the voting were as follows:

	For	Against
E. Douglas McLeod	200,000	-
Charles D. Milos	200,000	-
Frances A. Moody-Dahlberg	200,000	-
Ross R. Moody	200,000	-
Russell S. Moody	200,000	-
Louis E. Pauls, Jr.	200,000	-

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 31(a)	- Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31(b)	- Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32(a)	-	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

NATIONAL WESTERN LIFE INSURANCE COMPANY
(Registrant)

Date: August 7, 2007	/S/ Ross R. Moody Ross R. Moody President, Chief Operating Officer, and Director (Authorized Officer)
Date: August 7, 2007	/S/ Brian M. Pribyl Brian M. Pribyl Senior Vice President, Chief Financial & Administrative Officer and Treasurer (Principal Financial Officer)
Date: August 7, 2007	/S/ Kay E. Osbourn Kay E. Osbourn Vice President, Controller and Assistant Treasurer (Principal Accounting Officer)