

Spansion Inc.  
Form 10-Q  
November 08, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**Form 10-Q**

---

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-51666

---

**SPANSION INC.**

(Exact name of registrant as specified in its charter)

---

Delaware  
(State or other jurisdiction of  
incorporation or organization)

915 DeGuigne Drive

20-3898239  
(I.R.S. Employer

Identification No.)

94088

Edgar Filing: Spansion Inc. - Form 10-Q

**Sunnyvale, California**  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (408) 962-2500

---

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer   
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the close of business on November 1, 2007:

Class	Number of Shares
Class A Common Stock, \$0.001 par value	135,335,096
Class C Common Stock, \$0.001 par value	1

---

**Table of Contents**

Table of Contents

**INDEX**

	<b>Page No.</b>
Part I. Financial Information	
Item 1. <u>Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations – Three and Nine Months Ended September 30, 2007 and October 1, 2006</u>	3
<u>Condensed Consolidated Balance Sheets – September 30, 2007 and December 31, 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows – Nine Months Ended September 30, 2007 and October 1, 2006</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
Item 4. <u>Controls and Procedures</u>	37
Part II. Other Information	
Item 1. <u>Legal Proceedings</u>	38
Item 1A. <u>Risk Factors</u>	40
Item 6. <u>Exhibits</u>	64
<u>Signature</u>	65

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Spansion Inc.****Condensed Consolidated Statements of Operations****(in thousands, except per share amounts)****(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>Sep. 30,</b>	<b>Oct. 1,</b>	<b>Sep. 30,</b>	<b>Oct. 1,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net sales	\$ 408,605	\$ 458,740	\$ 1,197,270	\$ 855,475
Net sales to related parties <i>(Note 6)</i>	202,464	215,978	650,742	1,036,524
<b>Total net sales</b>	<b>611,069</b>	<b>674,718</b>	<b>1,848,012</b>	<b>1,891,999</b>
Operating expenses:				
Cost of sales <i>(including \$64,590, \$50,911, \$169,063 and \$164,234 of expenses charged by related parties)</i>	500,741	532,563	1,541,360	1,508,848
Research and development <i>(including \$322, \$3,551, \$1,100 and \$12,227 of expenses charged by related parties)</i>	111,231	89,174	323,892	262,954
Sales, general and administrative <i>(including \$168, \$4,019, \$1,089 and \$21,476 of expenses charged by related parties)</i>	58,226	62,951	177,027	195,253
<b>Total operating expenses</b>	<b>670,198</b>	<b>684,688</b>	<b>2,042,279</b>	<b>1,967,055</b>
<b>Operating loss</b>	<b>(59,129)</b>	<b>(9,970)</b>	<b>(194,267)</b>	<b>(75,056)</b>
Other income (expense), net:				
Gain on sale of marketable securities				6,884
Loss on early extinguishment of debt			(3,435)	(17,310)
Interest and other income, net	6,835	3,888	30,873	14,167
Interest expense <i>(including \$0, \$146, \$0 and \$11,875 of expenses on related party debt)</i>	(23,628)	(13,020)	(65,316)	(50,205)
<b>Other income (expense), net</b>	<b>(16,793)</b>	<b>(9,132)</b>	<b>(37,878)</b>	<b>(46,464)</b>
Loss before income taxes	(75,922)	(19,102)	(232,145)	(121,520)
(Benefit) provision for income taxes	(4,320)	3,013	(18,163)	1,231
<b>Net loss</b>	<b>\$ (71,602)</b>	<b>\$ (22,115)</b>	<b>\$ (213,982)</b>	<b>\$ (122,751)</b>
Net loss per common share:				
Basic and diluted	\$ (0.53)	\$ (0.17)	\$ (1.59)	\$ (0.96)
Shares used in per share calculation:				
Basic and diluted	135,049	128,800	134,805	128,470

**See accompanying notes**

**Table of Contents****Spansion Inc.****Condensed Consolidated Balance Sheets****(in thousands)**

	<b>Sep. 30,</b>	<b>Dec. 31,</b>
	<b>2007</b>	<b>2006 (*)</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 260,946	\$ 759,794
Marketable securities	268,150	125,975
Trade accounts receivable, net	171,109	199,850
Trade accounts receivable from related parties, net ( <i>Note 6</i> )	166,279	193,728
Other receivables from related parties ( <i>Note 6</i> )	8,502	2,325
Inventories:		
Raw materials	35,342	44,840
Work-in-progress	378,810	344,603
Finished goods	117,786	66,397
Total inventories	531,938	455,840
Deferred income taxes	32,424	1,395
Prepaid expenses and other current assets	62,866	36,163
Total current assets	1,502,214	1,775,070
Property, plant and equipment, net	2,234,153	1,735,694
Deferred income taxes	26,156	13,556
Other assets	45,292	25,397
Total assets	\$ 3,807,815	\$ 3,549,717
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Notes payable to banks under revolving loans	\$	\$ 33,608
Accounts payable	474,851	408,365
Accounts payable to related parties ( <i>Note 6</i> )	53,585	14,559
Accrued compensation and benefits	61,692	51,598
Accrued liabilities to related parties ( <i>Note 6</i> )	7,085	11,273
Other accrued liabilities	84,592	59,045
Income taxes payable	23,368	4,333
Deferred income on shipments to a related party	303	229
Deferred income on shipments	33,559	32,267
Current portion of long-term obligations to related parties ( <i>Note 8</i> )	500	500
Current portion of long-term debt	41,551	12,560
Current portion of long-term obligations under capital leases	43,138	61,706
Total current liabilities	824,224	690,043
Deferred income taxes	67	188
Long-term debt, less current portion	1,236,950	934,138

Edgar Filing: Spansion Inc. - Form 10-Q

Long-term obligations under capital leases, less current portion	49,832	75,535
Other long-term liabilities	32,020	4,053
Commitments and contingencies		
Stockholders' equity	1,664,722	1,845,760
Total liabilities and stockholders' equity	\$ 3,807,815	\$ 3,549,717

---

\* Derived from audited financial statements at December 31, 2006.

**See accompanying notes**

**Table of Contents****Spansion Inc.****Condensed Consolidated Statements of Cash Flows****(in thousands)****(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>Sep. 30,</b>	<b>Oct. 1,</b>
	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (213,982)	\$ (122,751)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	387,709	406,980
Loss on pension curtailment	2,010	
Loss on early extinguishment of debt	3,435	17,310
Provision for doubtful accounts	1,693	471
(Benefit) Provision for deferred income taxes	(43,537)	2,902
Net gain on sale and disposal of property, plant and equipment	(21,946)	(1,362)
Gain on sale of marketable securities		(6,884)
Compensation recognized under employee stock plans	12,084	19,797
Amortization of premium on floating rate notes and discount on senior subordinated and senior notes, net	1,745	2,559
Changes in operating assets and liabilities:		
Decrease in trade accounts receivable from related parties	26,796	204,497
(Increase) decrease in other receivables from related parties	(6,177)	10,300
Decrease (increase) in trade accounts receivable	27,700	(210,053)
Increase in inventories	(76,558)	(6,740)
Increase in prepaid expenses and other current assets	(28,019)	(10,519)
(Increase) decrease in other assets	(21,563)	353
Increase (decrease) in accounts payable and accrued liabilities to related parties	34,938	(110,982)
Increase in accounts payable and accrued liabilities	75,981	104,753
Decrease in accrued compensation and benefits	(965)	(8,541)
Increase (decrease) in income taxes payable	18,984	(11,375)
Increase (decrease) in deferred income on shipments to a related party	74	(31,901)
Increase in deferred income on shipments	1,291	35,759
Net cash provided by operating activities	181,693	284,573
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sale of property, plant and equipment	188,525	3,608
Purchases of property, plant and equipment	(964,666)	(470,830)
Proceeds from maturity and sale of marketable securities	679,900	282,583
Purchases of marketable securities	(822,075)	(63,612)
Net cash used in investing activities	(918,316)	(248,251)
<b>Cash Flows from Financing Activities:</b>		
Cash distribution to related parties for stock-based compensation		(7,238)
Proceeds from sale-leaseback transactions		29,769
Proceeds from borrowings, net of issuance costs	831,042	329,044
Proceeds from issuance of stock	60	
Payments on loans from related parties		(197,119)



## Edgar Filing: Spansion Inc. - Form 10-Q

Payments on debt and capital lease obligations	(580,004)	(330,030)
Net cash provided by (used in) financing activities	251,098	(175,574)
Effect of exchange rate changes on cash and cash equivalents	(13,323)	11,000
Net decrease in cash and cash equivalents	(498,848)	(128,252)
Cash and cash equivalents at the beginning of period	759,794	506,439
Cash and cash equivalents at end of period	\$ 260,946	\$ 378,187

**See accompanying notes**

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

Spansion Inc. is a semiconductor manufacturer headquartered in Sunnyvale, California, with manufacturing, research and assembly operations in the United States and Asia. The Company designs, develops, manufactures, markets and sells Flash memory solutions that encompass a broad spectrum of densities and features, which primarily address the integrated Flash memory market.

The Company's Flash memory devices are incorporated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, personal computers and PC peripheral applications.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The accompanying condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The condensed consolidated financial statements and notes thereto are unaudited. In the opinion of management, these financial statements contain all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the Company's operating results, financial position and cash flows. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any subsequent interim period or for the year ending December 30, 2007.

The condensed consolidated financial statements include all the accounts of the Company and those of its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

The condensed consolidated financial statements do not include certain financial footnotes and disclosures required under U.S. generally accepted accounting principles for audited financial statements. Therefore, the unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and footnotes thereto for the year ended December 31, 2006 included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC) on February 27, 2007.

The Company uses a 52- to 53-week fiscal year ending on the last Sunday in December. The three months ended September 30, 2007 and October 1, 2006 both consisted of 13 weeks. The nine months ended September 30, 2007 and October 1, 2006 consisted of 39 weeks and 40 weeks, respectively.

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

**Use of Estimates**

The preparation of financial statements and disclosures in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of commitments and contingencies and the reported amounts of revenues and expenses during the reporting periods. In particular, management makes estimates related to revenues, allowance for doubtful accounts, inventories, asset impairments, income taxes and pension expenses. Actual results may differ from those estimates, and such differences may be material to the financial statements.

**Financial Statement Reclassifications**

Certain prior period amounts in the condensed consolidated statements of operations have been reclassified to conform to the current period presentation. These reclassifications do not affect the Company's gross margin or operating results.

**Sabbatical Leave Program**

In June 2006, the Financial Accounting Standards Board (FASB) ratified the Emerging Issue Task Force (EITF) Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43*. Issue 06-2 provides guidelines under which sabbatical leave or other similar benefits provided to an employee are considered to accumulate. If such benefits are deemed to accumulate, they should be accrued for as compensation expense over the employee's requisite service period. The provisions of this Issue are effective for fiscal years beginning after December 15, 2006 and allow for either retrospective application or a cumulative effect adjustment approach upon adoption. The Company adopted this Issue beginning January 1, 2007 using the cumulative effect adjustment approach. The adoption of this Issue resulted in an increase to the Company's accumulated deficit of approximately \$10.0 million as of the beginning of fiscal 2007. The effect of this change on the Company's condensed consolidated statements of operations for the three and nine months ended September 30, 2007 is not material.

The Company's Sabbatical Program provides for eight weeks of paid leave for salaried (exempt) employees in the United States upon the completion of seven years of service. In addition, the Company's Recognition Trip Program provides for one week of paid leave and a fixed cash compensation for hourly (non-exempt) employees in the United States who have completed seven years of service. Prior to the adoption of the Issue, the Company accounted for the above programs only after the completion of the seven years by the eligible employees because none of the benefits vest or accrete to the employee until completion of the full seven years of service. With the adoption of Issue 06-2, the Company accounts for the programs by recording the estimated total program payouts upon attaining the requisite service conditions as compensation expense ratably over each employee's requisite service period.

**Income Taxes**

In July 2006, the FASB issued Financial Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on

---

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Adoption, on January 1, 2007, did not have a material effect on the Company's consolidated financial statements. The effect of this change on the Company's condensed consolidated statements of operations for the three months ended September 30, 2007 is not material. As of the date of the adoption, the Company's total gross unrecognized tax benefits were \$2.2 million, of which \$1.7 million, if recognized, would affect the Company's effective tax rate. For the three months ended September 30, 2007, the Company's total gross unrecognized tax benefits were \$3.5 million, of which \$2.5 million, if recognized, would affect the effective tax rate. The gross amount of the increase in unrecognized tax benefits from the date of adoption to the nine months ended September 30, 2007 was primarily due to an increase in unrecognized tax credits.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expenses and such amounts were immaterial in the nine months ended September 30, 2007.

The Company is subject to taxation in the United States and various states and foreign jurisdictions. The Company's tax years 2003 through 2006 are subject to examination by the tax authorities. With few exceptions, the Company is not subject to U.S. federal, state, local or foreign examinations by tax authorities for years before 2003.

The Company does not believe that it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months.

### **3. Stock-Based Compensation**

#### **Plan Descriptions**

On May 29, 2007, the Company's stockholders approved the Spansion Inc. 2007 Equity Incentive Plan (the "2007 Plan"). The maximum number of shares of the Company's Class A Common Stock that may be issued or transferred pursuant to awards under the 2007 Plan equals the sum of: (1) 6,675,000 shares, plus (2) the number of shares available for award grant purposes under the Company's 2005 Equity Incentive Plan (the "2005 Plan") as of May 29, 2007, plus (3) the number of any shares subject to stock options and restricted stock or restricted stock unit (RSU) awards granted under the 2005 Plan and outstanding as of May 29, 2007 which expire, or for any reason are cancelled or terminated, after that date without being exercised or paid. As of May 29, 2007, approximately 920,523 shares were available for award grant purposes under the 2005 Plan, and approximately 7,091,852 shares were subject to options and restricted stock or RSU awards then outstanding under the 2005 Plan.

The 2007 Plan provides that grants may be awarded to an officer or employee, a consultant or advisor, or a non-employee director of the Company or its subsidiaries. Stock options and RSU awards issued under the 2007 Plan generally vest 25 percent after one year, and the balance vest ratably on a quarterly basis over the following three years and expire if not exercised by the seventh anniversary of the grant date. RSU awards have no exercise price or expiration date.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)****Shares Available to Grant**

Number of shares available for grant under the 2005 Plan and 2007 Plan:

Number of shares available for grant under the 2005 Equity Incentive Plan:	
Amount reserved for grant	9,500,000
Stock options granted through September 30, 2007, net of cancelled stock options	(3,484,904)
RSU awards granted through September 30, 2007, net of cancelled RSU awards	(4,969,444)
Shares transferred to the 2007 Plan	(920,523)
Shares available under the 2005 Plan <sup>(1)</sup>	125,129
Number of shares available for grant under the 2007 Equity Incentive Plan:	
Amount reserved for grant <sup>(2)</sup>	7,595,523
Stock options granted through September 30, 2007, net of cancelled stock options	(214,250)
RSU awards granted through September 30, 2007, net of cancelled RSU awards	(209,990)
Shares available for grant under the 2007 Plan	7,171,283

<sup>(1)</sup> The remaining available shares under the 2005 Plan were related to stock options or RSU awards which were cancelled subsequent to May 29, 2007 and will be transferred to the 2007 Plan in future periods.

<sup>(2)</sup> The 7,595,523 shares reserved for grant under the 2007 Plan consisted of 6,675,000 shares approved for grant under the 2007 Plan and 920,523 shares transferred from the 2005 Plan.

**Valuation and Expense Information**

The following table sets forth the total recorded stock-based compensation expense, by financial statement caption, resulting from the Company's stock options and restricted stock unit awards for the three and nine months ended September 30, 2007 and October 1, 2006:

	Three Months Ended		Nine Months Ended	
	Sep. 30, 2007	Oct. 1, 2006	Sep. 30, 2007	Oct. 1, 2006
	( in thousands)			
Cost of sales	\$ 2,372	\$ 1,585	\$ 6,042	\$ 6,839
Research and development	1,185	792	3,021	3,421
Sales, general and administrative	1,185	792	3,021	3,421
Stock-based compensation expense before income taxes	4,742	3,169	12,084	13,681
Income tax benefit <sup>(1)</sup>				

## Edgar Filing: Spansion Inc. - Form 10-Q

Stock-based compensation expense after income taxes <sup>(1)</sup>

\$ 4,742   \$ 3,169   \$ 12,084   \$ 13,681

---

<sup>(1)</sup> There is no income tax benefit relating to stock option expenses because all of the Company's U.S. deferred tax assets, net of U.S. deferred tax liabilities, continue to be subjected to a full valuation allowance.

The weighted average fair value of the Company's stock options granted in the three months ended September 30, 2007 and October 1, 2006 was \$3.68 and \$8.44 per share, respectively. The weighted average fair value of the Company's stock options granted in the nine months ended September 30, 2007 and October 1, 2006, was \$4.80 and \$7.95 per share, respectively. The fair value of each stock option was estimated at the date of grant using a Black-Scholes-Merton option pricing model, with the following assumptions for grants in the three and nine months ended September 30, 2007 and October 1, 2006:

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	Sep. 30, 2007	Oct. 1, 2006	Sep. 30, 2007	Oct. 1, 2006
Expected volatility	45.32%	55.80%	48.50%	59.22%
Risk-free interest rate	4.12%	5.10%	4.73%	4.93%
Expected term (in years)	4.61	4.61	4.61	4.59
Dividend yield	0%	0%	0%	0%

The Company's dividend yield is zero because the Company has never paid dividends and does not have plans to do so over the expected life of the stock options. The expected volatility is based on the Company's recent historical volatility and the volatilities of the Company's competitors who are in the same industry sector with similar characteristics (guideline companies) given the limited historical realized volatility data of the Company. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bond with a remaining term equal to the expected stock option life. The expected term is based on the shortcut approach provided in SAB 107 for developing the estimate of the expected life of a plain vanilla stock option. Under this approach, the expected term is presumed to be the mid-point between the average vesting date and the end of the contractual term.

As of September 30, 2007, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately \$52.2 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2011.

**Stock Option and Restricted Stock Unit Activity**

The following table summarizes stock option activity and related information for the period presented:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value  (in thousands)
Outstanding as of December 26, 2005 <sup>(1)</sup>	1,949,750	\$ 12.00		
Granted	462,500	\$ 14.93		
Cancelled	(277,344)	\$ 12.00		
Outstanding as of December 31, 2006	2,134,906	\$ 12.63	6.08	\$ 4,761
Granted	1,775,062	\$ 10.39		
Cancelled	(210,814)	\$ 13.41		
Exercised	(5,000)	\$ 12.00		
Outstanding as of September 30, 2007	3,694,154	\$ 11.51	5.91	\$ 37
Exercisable as of September 30, 2007 <sup>(2)</sup>	698,412	\$ 12.27	5.24	\$

<sup>(1)</sup> Outstanding shares at the beginning of fiscal 2006 were the shares granted upon the Company's initial public offering (IPO) on December 15, 2005.

<sup>(2)</sup>

## Edgar Filing: Spansion Inc. - Form 10-Q

There were 698,412 shares vested and exercisable as of September 30, 2007, with a total grant date fair value of approximately \$8.6 million.



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)**

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$8.45 as of September 28, 2007, which was the last trading day prior to September 30, 2007, which would have been received by the stock option holders had all stock option holders exercised their stock options as of that date.

The following table summarizes RSU award activity and related information for the period presented:

	<b>Number of Shares</b>	<b>Weighted- Average Grant-date Fair Value</b>
Unvested as of December 26, 2005 <sup>(1)</sup>	3,604,090	\$ 12.00
Granted	362,434	\$ 15.23
Cancelled	(217,021)	\$ 13.02
Vested	(825,888)	\$ 12.00
Unvested as of December 31, 2006	2,923,615	\$ 12.33
Granted	1,649,837	\$ 10.45
Cancelled	(219,906)	\$ 12.19
Vested	(899,839)	\$ 12.17
Unvested as of September 30, 2007	3,453,707	\$ 11.48

<sup>(1)</sup> Unvested shares at the beginning of fiscal 2006 were the shares granted upon the Company's IPO on December 15, 2005.

**4. Net Loss per Share**

The Company excluded an aggregate of 18.9 million shares issuable upon exercise of outstanding stock options, upon vesting of outstanding RSUs and upon conversion of Spansion LLC's 2.25% Exchangeable Senior Secured Debentures from the calculation of diluted earnings per share for the three and nine months ended September 30, 2007 because they had an antidilutive effect due to the net losses recorded in those periods.

The Company excluded an aggregate of 16.8 million shares issuable upon exercise of outstanding stock options, upon vesting of outstanding RSUs and upon conversion of Spansion LLC's 2.25% Exchangeable Senior Secured Debentures from the calculation of diluted earnings per share for the three and nine months ended October 1, 2006 because they had an antidilutive effect due to the net losses recorded in those periods.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)****5. Comprehensive Loss**

The following are the components of comprehensive loss:

	Three Months Ended		Nine Months Ended	
	Sep. 30, 2007	Oct. 1, 2006	Sep. 30, 2007	Oct. 1, 2006
	(in thousands)			
Net loss	\$ (71,602)	(22,115)	\$ (213,982)	\$ (122,751)
Amortization of prior service cost	99		293	
Pension curtailment loss			2,010	
Net change in cumulative translation adjustment	47,497	(20,543)	28,038	(2,726)
Net change in unrealized gains on marketable securities, net of \$0 taxes				(7,291)
Total comprehensive loss	\$ (24,006)	\$ (42,658)	\$ (183,641)	\$ (132,768)

**6. Related Party Transactions**

Prior to the second quarter of fiscal 2006, the Company relied on AMD and Fujitsu as sole distributors of its products. In the second quarter of fiscal 2006, the Company began selling its products directly to the customers previously served by AMD. The Company receives certain administrative services from AMD and Fujitsu. The charges for these services are negotiated annually between the Company and AMD and Fujitsu based on the Company's expected requirements and the estimated future costs of the services to be provided. AMD has the right to review the proposed services to be provided by Fujitsu, and Fujitsu has the right to review the proposed services to be provided by AMD. The service charges are billed monthly on net 45 day terms.

The following tables present significant related party transactions and account balances between the Company and AMD (see Note 8 for separate disclosure of borrowing arrangements with related parties):

	Three Months Ended		Nine Months Ended	
	Sep. 30, 2007	Oct. 1, 2006	Sep. 30, 2007	Oct. 1, 2006
	(in thousands)			
Net sales to AMD <sup>(1)</sup>	\$	\$	\$	\$ 336,172
Cost of sales:				
Royalties to AMD	\$ 797	\$ 1,739	\$ 2,352	\$ 4,837
Service fees to AMD <sup>(2)</sup> :				
Cost of sales	\$ 15	\$ 553	\$ (1,100)	\$ 3,272
Research and development	(2)	2,984	177	10,273
Sales, general and administrative	142	3,005	356	18,163
Total service fees to AMD	\$ 156	\$ 6,542	\$ (566)	\$ 31,708

- 
- (1) In the second quarter of fiscal 2006, the Company began selling its products directly to the customers previously served by AMD.
- (2) Service fees to AMD are net of reimbursements from AMD for services provided to AMD by the Company.

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

	Sep. 30, 2007	Dec. 31, 2006
	(in thousands)	
Trade accounts receivable from AMD, net of allowance for doubtful accounts	\$ 2,906	\$ 3,400
Other receivables from AMD	\$ 5,338	\$ 2,325
Accounts payable to AMD	\$ 3,323	\$ 1,513
Royalties payable to AMD	\$ 797	\$ 3,130
Accrued liabilities to AMD	\$ 213	\$ 43

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)**

The following tables present the significant related party transactions and account balances between the Company and Fujitsu (see Note 8 for separate disclosure of borrowing arrangements with related parties):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>Sep. 30, 2007</b>	<b>Oct. 1, 2006</b>	<b>Sep. 30, 2007</b>	<b>Oct. 1, 2006</b>
	(in thousands)			
Net sales to Fujitsu	\$ 202,464	\$ 215,978	\$ 650,742	\$ 700,352
Cost of sales:				
Royalties to Fujitsu	\$ 797	\$ 1,739	\$ 2,352	\$ 4,837
Other purchases of goods and services from Fujitsu and rental expense to Fujitsu	15,744	31,942	59,645	91,721
Subcontract manufacturing and commercial die purchases from Fujitsu	2,725	14,388	17,602	57,814
Wafer purchases, processing and sort services from Fujitsu <sup>(1)</sup>	63,274		122,236	
Net gain recognized on sale of assets to Fujitsu on April 2, 2007 <sup>(1)</sup>	(10,278)		(19,845)	
Reimbursement on costs of employees seconded to Fujitsu <sup>(1)</sup>	(6,351)		(12,319)	
Pension curtailment loss <sup>(1)</sup>			2,010	
Equipment rental income from Fujitsu <sup>(1)</sup>	(1,884)		(3,914)	
Administrative services income from Fujitsu <sup>(1)</sup>	(325)		(615)	
	\$ 63,701	\$ 48,069	\$ 167,151	\$ 154,372
Service fees to Fujitsu:				
Cost of sales	\$ 77	\$ 550	\$ 660	\$ 1,726
Research and development	324	567	923	1,893
Sales, general and administrative	26	1,014	733	3,218
Service fees to Fujitsu	\$ 426	\$ 2,131	\$ 2,316	\$ 6,837
Cost of employees seconded from Fujitsu:				
Cost of sales	\$	\$	\$	\$ 27
Research and development				61
Sales, general and administrative				95
Cost of employees seconded from Fujitsu	\$	\$	\$	\$ 183

<sup>(1)</sup> These amounts relate to the JV1/JV2 Transaction which was consummated on April 2, 2007.

	<b>Sep. 30, 2007</b>	<b>Dec. 31, 2006</b>
	(in thousands)	
Trade accounts receivable from Fujitsu	\$ 163,373	\$ 190,328
Other receivables from Fujitsu	\$ 3,164	\$
Accounts payable to Fujitsu	\$ 50,262	\$ 13,046

## Edgar Filing: Spansion Inc. - Form 10-Q

Royalties payable to Fujitsu	\$ 797	\$ 3,130
Accrued liabilities to Fujitsu	\$ 5,377	\$ 4,970

The Company licenses certain intellectual property from AMD and Fujitsu in exchange for the payment of royalties to both AMD and Fujitsu. These royalty expenses are recognized in cost of sales.

---

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

The Company is required to pay AMD and Fujitsu semi-annual royalties based on net sales (minus the costs of commercial die). The royalty as a percentage of sales will decline to zero over a specified time. The term of the agreement expires in 2013.

Fujitsu provides test and assembly services to the Company on a contract basis. The Company also purchases commercial die from Fujitsu, which is packaged together with the Company's Flash memory devices.

Fujitsu seconded certain employees to the Company until the second quarter of fiscal 2006. The Company paid these employees directly.

**JV1/JV2 Transaction and Related Agreements**

On April 2, 2007, Spansion Japan closed the JV1/JV2 transaction (the Transaction) pursuant to the Asset Purchase Agreement dated as of September 28, 2006 (the JV1/JV2 Closing). Under the terms of the Asset Purchase Agreement, Spansion Japan sold two wafer fabrication facilities located in Aizu-Wakamatsu, Japan (JV1/JV2 Facilities) to Fujitsu, together with selected manufacturing equipment, inventory and other tangible assets located at the JV1/JV2 Facilities, and received proceeds of approximately \$170.0 million in cash from Fujitsu. In conjunction with the Transaction on April 2, 2007, Spansion Japan also sold certain equipment located at the JV1/JV2 Facilities to an unrelated third party Japanese corporation for approximately \$24.0 million, which is leasing the equipment to Fujitsu.

In connection with the Transaction, Spansion Japan and Fujitsu also entered into the following agreements:

*Foundry Agreement*

Spansion Japan and Fujitsu entered into a Foundry Agreement, pursuant to which Fujitsu provides the Company certain foundry services for the manufacture of the Company's products at the JV1/JV2 Facilities.

Fujitsu began to provide foundry services to the Company commencing on April 2, 2007. The terms of the Foundry Agreement commit the Company to purchase a minimum specified number of wafers (within a range) over an initial period from April 2007 to June 2008 and provide for financial penalties if such purchase commitments are not achieved. In addition, the terms provide for both parties to negotiate in good faith to agree, by December 31, 2007, the above commitments for periods from July 2008 to December 2009. The initial term of the Foundry Agreement ends on December 31, 2009. Spansion Japan and Fujitsu have agreed to enter into discussions prior to December 31, 2008 in order to decide whether or not to extend the initial term of the Foundry Agreement and Fujitsu has agreed to give Spansion Japan at least 12 months prior notice of its intent to cease providing foundry services to Spansion Japan under the Foundry Agreement. Either Spansion Japan or Fujitsu may terminate the Foundry Agreement in the event that the other party fails to correct or cure its material breach under the Foundry Agreement within 60 days of receipt of written notice from the non-defaulting party specifying such breach.

*Secondment and Transfer Agreement*

Spansion Japan and Fujitsu entered into a Secondment and Transfer Agreement (the Secondment Agreement), pursuant to which Spansion Japan seconded certain employees to Fujitsu commencing April 2, 2007. In addition, certain employees will ultimately be transferred to Fujitsu. Unless the parties

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

otherwise agree, the period of secondment for seconded employees not designated for transfer will end no later than June 30, 2008, and no later than December 31, 2009 for seconded employees designated for transfer.

The seconded employees remain employees of Spansion Japan and remain eligible to participate in Spansion Japan's various benefit plans through the term of the secondment. Fujitsu is required to reimburse Spansion Japan for all compensation and expenses associated with such seconded employees and incurred by Spansion Japan during the secondment period.

The Secondment Agreement can be terminated (i) by the mutual written agreement of Spansion Japan and Fujitsu, (ii) by either Spansion Japan or Fujitsu in the event that the other party materially defaults in the performance of a material obligation under the Secondment Agreement and the breaching party has not cured such breach within 120 days after receipt of notice of default by the non-breaching party and (iii) by either Spansion Japan or Fujitsu in the event that the other party is subject to bankruptcy or insolvency proceedings. The Secondment Agreement automatically terminates (i) on the transfer date of the last of the transferred employees or (ii) upon the termination of the Foundry Agreement unless otherwise agreed by Spansion Japan and Fujitsu.

*Master Lease Agreement*

Spansion Japan and Fujitsu entered into a Master Lease Agreement for certain equipment located at the JV1/JV2 Facilities. On April 2, 2007, Spansion Japan began to lease to Fujitsu the equipment under the Master Lease Agreement. Fujitsu has the option to renew or extend the lease term for any or all of the equipment at the end of the initial term or any extension thereof for up to six months. If specified demand targets for wafers are not met, and subject to conditions described in the Master Lease Agreement, each of Spansion Japan and Fujitsu will have a right to terminate the lease of some or all of the leased equipment on or after June 30, 2008, by giving notice to the other party prior to December 31, 2007.

Subject to the terms of the Master Lease Agreement, at the expiration of the applicable term, Fujitsu will have a right of first refusal in the event of the sale by Spansion Japan of any equipment for a purchase price equal to the highest offer received from a third party. In addition, Fujitsu will have the option to purchase any or all of the equipment at the expiration of the applicable term, upon any early lease termination or if any equipment is not returned in its proper condition, for a purchase price equal to the fair market value of the equipment at the time of purchase or any other purchase price as may be set forth in the applicable schedule.

*Wafer Processing Services Agreement*

Spansion Japan and Fujitsu entered into a Wafer Processing Services Agreement (the "Wafer Processing Agreement"), pursuant to which Fujitsu will provide certain wafer processing services to Spansion Japan at the JV1/JV2 Facilities. The term of the Wafer Processing Agreement commenced on April 2, 2007 and is effective until December 31, 2009. The Wafer Processing Agreement will automatically terminate upon termination or expiration of the Foundry Agreement. Either Spansion Japan or Fujitsu may terminate the Wafer Processing Agreement in the event that the other party fails to correct or cure any material breach by such other party of any covenant or obligation under the Wafer Processing Agreement within 60 days of receipt of written notice from the non-defaulting party specifying such breach.



**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

*Sort Services Agreement*

Spansion Japan and Fujitsu entered into a Sort Services Agreement (the *Sort Services Agreement*), pursuant to which Fujitsu will provide probe testing services of Spansion Japan's wafers at the JV1/JV2 Facilities (the *Sort Services*). The term of the Sort Services Agreement commenced on April 2, 2007 and is effective until December 31, 2009. Spansion Japan may terminate the Sort Services Agreement in its sole discretion with 60 days' prior written notice to Fujitsu, and either Spansion Japan or Fujitsu may terminate the Sort Services Agreement in the event that the other party fails to correct or cure any material breach by such other party of any covenant or obligation under the Sort Services Agreement within 60 days of receipt of written notice from the non-defaulting party specifying such breach.

*Rental Agreement*

Spansion Japan and Fujitsu entered into a Rental Agreement (the *Rental Agreement*), pursuant to which Spansion Japan will rent certain equipment (the *Rental Equipment*) to Fujitsu for the sole purpose of fulfilling the obligations of Fujitsu in the Sort Services Agreement. Spansion Japan will retain title to the Rental Equipment at all times, and Fujitsu is prohibited from selling, pledging or otherwise encumbering or disposing of the Rental Equipment. The term of the Rental Agreement commenced on April 2, 2007 and is effective until the termination or expiration of the Sort Services Agreement.

*Services Agreement*

Spansion Japan and Fujitsu entered into a Services Agreement (the *Services Agreement*), pursuant to which Spansion Japan will provide certain human resource services and information technology ( *IT* ) services to Fujitsu (collectively, the *Services*). Any services are to be provided pursuant to statements of work, which may be updated by Spansion Japan and Fujitsu from time to time upon mutual agreement. Spansion Japan will provide the Services to Fujitsu at cost plus five percent. The term of the Services Agreement commenced on April 2, 2007 and is effective until March 31, 2009. Fujitsu may terminate all or a part of any individual Service at any time with six months' advance notice to Spansion Japan.

The total gain from the Transaction, which was the difference between the sales proceeds and the net book value of the assets sold under the terms of the agreement, was approximately \$72.5 million as of April 2, 2007. The Company accounted for the Transaction in accordance with FASB Statement No. 66, *Accounting for Sales of Real Estate*, as a sale of real estate that included property improvements and integral equipment, because the building was subject to an existing lease of the underlying land. The Company determined that continuing involvement existed with Fujitsu under the Foundry Agreement effective until December 2009 and, accordingly, will recognize the gain over the term of the Foundry Agreement (i.e., over the period of continuing involvement).

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)****7. Warranties and Indemnities**

The Company generally offers a one-year limited warranty for its Flash memory products.

Changes in the Company's liability for product warranty during the three and nine months ended September 30, 2007 and October 1, 2006 are as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>Sep. 30, 2007</b>	<b>Oct. 1, 2006</b>	<b>Sep. 30, 2007</b>	<b>Oct. 1, 2006</b>
	<b>(in thousands)</b>			
Balance, beginning of period	\$ 1,600	\$ 1,000	\$ 1,350	\$ 1,000
Provision for warranties issued	1,095	1,293	3,579	2,977
Settlements	(446)	(255)	(1,554)	(2,497)
Changes in liability for pre-existing warranties during the period, including expirations	(649)	(688)	(1,775)	(130)
Balance, end of period	\$ 1,600	\$ 1,350	\$ 1,600	\$ 1,350

In addition to product warranties, the Company, from time to time in its normal course of business, indemnifies other parties with whom it enters into contractual relationships, including customers, directors, lessors and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other parties harmless against specified losses, such as those arising from a breach of representations or covenants, third-party infringement claims or other claims made against certain parties. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim and indemnification provision.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)****8. Debt and Capital Lease Obligations**

The Company's debt and capital lease obligations consist of:

	Sep. 30, 2007	Dec. 31, 2006
	(in thousands)	
Debt obligations to related parties:		
Promissory Note payable to AMD	\$ 500	\$ 500
<b>Total debt obligations to related parties</b>	<b>500</b>	<b>500</b>
Debt obligations to third parties:		
Spansion China Bank Enterprise Cooperation Revolver	6,825	7,925
Senior Notes	230,029	228,231
Spansion Japan 2006 Revolving Credit Facility		8,402
Spansion Penang Loan	2,398	3,543
Spansion Japan 2006 Merged Revolving Credit Facility		16,804
Exchangeable Senior Subordinated Debentures	207,000	207,000
Spansion Japan 2006 Uncommitted Revolving Credit Facility		8,402
Senior Secured Term Loan Facility		500,000
Spansion Japan 2007 Credit Facility	206,458	
Senior Secured Floating Rate Notes	625,791	
Obligations under capital leases	92,970	137,240
<b>Total debt obligations to third parties</b>	<b>1,371,471</b>	<b>1,117,547</b>
<b>Total debt obligations</b>	<b>1,371,971</b>	<b>1,118,047</b>
Less current portion	85,189	108,374
<b>Long-term debt and capital lease obligations, less current portion</b>	<b>\$ 1,286,782</b>	<b>\$ 1,009,673</b>

**New Debt and Capital Lease Obligations and Activities for the nine months ended September 30, 2007:****Debt Obligations to Third Parties***Spansion Japan 2006 Revolving Credit Facility*

In March 2007, Spansion Japan repaid the remaining principal balance and accrued interest under this facility and voluntarily terminated the facility.

*Spansion Japan 2006 Merged Revolving Credit Facility*

## Edgar Filing: Spansion Inc. - Form 10-Q

In April 2007, Spansion Japan repaid the remaining principal balance and accrued interest under this facility and no amounts were outstanding under this credit facility as of September 30, 2007.

### *Spansion Japan 2006 Uncommitted Revolving Credit Facility*

In April 2007, Spansion Japan repaid the remaining principal balance and accrued interest under this facility and no amounts were outstanding under this credit facility as of September 30, 2007.

---

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

***Senior Secured Term Loan Facility***

In May 2007, in connection with the issuance of its Senior Secured Floating Rate Notes (see below), the Company repaid and cancelled the Senior Secured Term Loan Facility of \$500.0 million principal amount. The Company recognized a loss on early extinguishment of debt of approximately \$3.4 million as a result of the write-off of unamortized Senior Secured Term Loan Facility issuance costs.

***Spansion Japan 2007 Credit Facility***

On March 30, 2007, Spansion Japan entered into a committed senior facility agreement with certain Japanese financial institutions that provide Spansion Japan with a 48.4 billion yen senior secured term loan facility (approximately \$421.6 million as of September 30, 2007).

Spansion Japan may, pursuant to the terms of this facility, borrow amounts in increments of 1.0 billion yen (approximately \$8.7 million as of September 30, 2007). Amounts borrowed under this facility bear interest at a rate equal to the Japanese yen three month Tokyo Interbank Offered Rate, or Japanese yen TIBOR, at the time of the drawdown, plus a margin of two percent per annum, which will reset quarterly. Borrowing availability is based on capital deliveries for Spansion Japan's SP1 facility.

Pursuant to the terms of Spansion Japan 2007 Credit Facility, Spansion Japan is not permitted, among other things, to create any security interests or liens on any of its pledged assets and to sell or dispose of any of its pledged assets, subject to certain exceptions including the sale of JV1/JV2. This facility may be terminated in the event of default in accordance with the terms of this facility. Events of default under the facility include, among other things, the following: a default in performance of payment; if any of debt obligations of Spansion LLC exceeding \$25.0 million, or of Spansion Japan exceeding 1.0 billion yen, are not paid when due; or if any debt obligations of Spansion Japan or Spansion LLC are accelerated or otherwise become due and payable, in each case if not cured within applicable time periods set forth in the Spansion Japan 2007 Credit Facility.

As of September 30, 2007, the outstanding balance under this facility is 23.7 billion yen (approximately \$206.5 million). This amount bears interest at approximately 2.84 percent and 80 percent of the balance will be repaid in ten equal, consecutive, quarterly principal installments starting from the second quarter of fiscal 2008 through the third quarter of fiscal 2010 and the remaining balance will be paid in the fourth quarter of fiscal 2010.

***Senior Secured Floating Rate Notes***

In May 2007, Spansion LLC, the wholly owned operating company subsidiary of the Company, issued \$625.0 million aggregate principal amount of the Senior Secured Floating Rate Notes due 2013 (the Notes). Interest on the Notes accrues at a rate per annum, reset quarterly, equal to the 3-month London Interbank Offered Rate plus 3.125 percent. Interest is payable on March 1, June 1, September 1 and December 1 of each year beginning September 1, 2007 until the maturity date of June 1, 2013. As of September 30, 2007, the Notes bear interest at approximately 8.82 percent.

In connection with the issuance of the Notes, the Company, Spansion LLC and Spansion Technology Inc. executed a pledge and security agreement pursuant to which and subject to exceptions specified therein, the Notes are secured by a first priority lien on all of Spansion LLC's inventory (excluding returned inventory), equipment and real property and proceeds thereof (excluding receivables or proceeds arising from sales of inventory in the ordinary course of business), presently owned or

---

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

acquired in the future by Spansion LLC and by each of the current and any future guarantors. The Notes are also secured by a second-priority lien that is junior to the liens securing Spansion LLC's Revolving Credit Agreement dated as of September 19, 2005, as amended, on substantially all other real and personal property and proceeds thereof, including receivables or proceeds arising from sales of inventory in the ordinary course of business presently owned or acquired in the future by the Company and by each of the current and any future guarantors. The Notes are further secured by certain deeds of trust related to real property owned by Spansion LLC in California and Texas.

Holders of the Notes may require Spansion LLC to repurchase the Notes for cash equal to 101 percent of the aggregate principal amount to be repurchased plus accrued and unpaid interest upon the occurrence of a change of control of Spansion LLC. Beginning June 1, 2008, Spansion LLC may redeem all or any portion of the Notes, at any time or from time to time at redemption prices specified therein. Prior to June 1, 2008, Spansion LLC may redeem up to 35 percent of the Notes from the proceeds of certain equity offerings at a redemption price of 100 percent.

Certain events are considered Events of Default, which may result in the accelerated maturity of the Notes, including:

Spansion LLC's failure to pay when due the principal or premium amount on any of the Notes at maturity, upon acceleration, redemption, optional redemption, required repurchase or otherwise;

Spansion LLC's failure to pay interest on any of the Notes for 30 days after the date when due;

Spansion LLC's or the guarantors' failure to comply with certain restrictions on Spansion LLC's or Guarantors' ability to merge, consolidate or sell substantially all of its assets;

Spansion LLC's failure to perform or observe any other covenant or agreement in the Notes or in the Indenture for a period of 45 days after receiving notice of such failure;

A default by Spansion LLC or any restricted subsidiary (as defined in the Indenture) under any indebtedness that results in acceleration of such indebtedness, or the failure to pay any such indebtedness at maturity, in an aggregate principal amount in excess of \$50.0 million (or its foreign equivalent at the time);

If any judgment or judgments for the payment of money in an aggregate amount in excess of \$50.0 million (or its foreign equivalent at the time) is rendered against Spansion LLC, the guarantors or any significant subsidiary and is not waived, satisfied or discharged for any period of 60 consecutive days during which a stay of enforcement is not in effect;

Certain events of bankruptcy, insolvency or reorganization with respect to Spansion LLC or any significant subsidiary;

If any note guaranty ceases to be in full force and effect, other than in accordance with the terms of the Indenture, or a guarantor denies or disaffirms its obligations under its note guaranty, other than in accordance with the terms of the Indenture; or

Any lien securing the collateral underlying the Notes at any time ceases to be in full force and effect, and does not constitute a valid and perfected lien on any material portion of the collateral intended to be covered thereby, if such default continues for 30 days after notice.

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

**9. Income Taxes**

The Company recorded an income tax benefit of \$4.3 million in the three months ended September 30, 2007 as compared to \$3.0 million of tax expenses in the three months ended October 1, 2006. The income tax benefit recorded in the three months ended September 30, 2007 was primarily due to a \$5.2 million decrease in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary, offset by tax provisions of its other foreign subsidiaries of \$0.9 million. This decrease of the valuation allowance was made as the Company believes that it is more likely than not that these deferred tax assets will be realized. The income tax benefit for the three months ended September 30, 2007 represents the portion of the deferred tax assets that will be recognized in the current year as part of the current year effective tax rate. As part of the Company's projected tax provision for the current year, the Company anticipates an increase of its valuation allowance against the Company's U.S. deferred tax assets to offset the tax benefits for current year losses in the U.S. The income tax expense recorded in the three months ended October 1, 2006 was primarily due to tax provisions of the Company's foreign subsidiaries of \$1.5 million and the write-off of U.S. deferred tax assets of \$1.5 million that the Company no longer believed were realizable.

The Company recorded an income tax benefit of \$18.2 million in the nine months ended September 30, 2007 as compared to \$1.2 million of income tax expenses in the nine months ended October 1, 2006. The income tax benefit recorded in the nine months ended September 30, 2007 was primarily due to a decrease of \$21.0 million in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary, offset by a tax provision of \$2.8 million of its foreign subsidiaries. During the first quarter of fiscal 2007, the Company recorded the effect of the change in judgment about the realizability of its Japanese deferred tax assets. This amount included the effect of the change in the beginning of the year balance of the valuation allowance that will be realized in future years, which was recorded during the first quarter. The amount recorded in the nine months ended September 30, 2007 also included the portion of the valuation allowance that will be recognized in the current year as part of the effective tax rate. The income tax expense recorded in the nine months ended October 1, 2006 was primarily due to tax provisions of the Company's foreign subsidiaries of \$4.3 million and the write-off of U.S. deferred tax assets of \$1.5 million that the Company no longer believed were realizable, partially offset by a benefit from resolution of a tax examination in a foreign jurisdiction of \$4.6 million.

As of September 30, 2007, all of the Company's U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance that was initially established in the fourth quarter of fiscal 2005 upon its conversion to a taxable entity immediately prior to its IPO due to continuing operating losses incurred by Spansion Inc. The realization of these assets is dependent on substantial future taxable income which at September 30, 2007, in management's estimate, is not more likely than not to be achieved.



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(Unaudited)****10. Spansion Japan Pension Plan**

The following table summarizes the components of the net periodic pension expense related to the Spansion Japan pension plan for the three and nine months ended September 30, 2007 and October 1, 2006:

	Three Months Ended		Nine Months Ended	
	Sep. 30,	Oct. 1,	Sep. 30,	Oct. 1,
	2007	2006	2007	2006
	(in thousands)			
Service cost	\$ 909	\$ 1,262	\$ 3,547	\$ 3,838
Interest cost	273	374	1,064	1,139
Expected return on plan assets	(596)	(694)	(2,325)	(2,109)
Amortization of prior service cost	102	182	2,307	554
<b>Total net periodic pension expense</b>	<b>\$ 688</b>	<b>\$ 1,124</b>	<b>\$ 4,593</b>	<b>\$ 3,422</b>

On April 2, 2007, in accordance with FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, the Company recorded a curtailment loss, which was included in the amortization of prior service cost, of approximately \$2.0 million relating to the Spansion Japan Pension Plan as a result of entering into the Employer Secondment and Transfer Agreement with Fujitsu under the JV1/JV2 transaction (see Note 6 for details of this transaction).

**11. Subsequent Events**

Merger Agreement with Saifun Semiconductors Ltd. ( Saifun )

On October 8, 2007, the Company and Saifun entered into an Agreement and Plan of Merger and Reorganization, dated as of October 7, 2007 (the Merger Agreement ), pursuant to which Atlantic Star Merger Sub Ltd., a wholly owned subsidiary of the Company, would merge (the Merger ) with and into Saifun, with Saifun surviving as a wholly owned subsidiary of the Company.

Subject to the terms and conditions of the Merger Agreement, which has been approved by the boards of directors of both companies, each Saifun shareholder will receive 0.7429 shares of the Company's Class A common stock and approximately \$5.05 per share in cash (representing a distribution of approximately \$158.3 million of Saifun's existing cash to all holders of record immediately prior to the consummation of the merger) for each Saifun ordinary share. Saifun's stock options will convert upon completion of the Merger into stock options with respect to the Company's common stock upon completion of the Merger, after giving effect to the exchange ratio in the Merger and the cash distribution.

The Merger Agreement contains customary covenants of the Company and Saifun, including, among others, a covenant by Saifun to conduct its business in the ordinary course during the interim period between the execution of the Merger Agreement and consummation of the Merger and restrictions on certain kinds of transactions during such period. The board of directors of Saifun has adopted a resolution recommending the requisite approval of the Merger by its shareholders, and has agreed to hold a shareholder and any necessary creditor meetings to consider and vote upon the transactions contemplated by the Merger Agreement. Saifun has also agreed not to (i) solicit proposals relating to alternative business combination transactions or (ii) subject to certain exceptions, enter into discussions or an agreement concerning or provide confidential information in connection with any proposals for alternative business combination transactions.

## Edgar Filing: Spansion Inc. - Form 10-Q

Consummation of the Merger is subject to certain conditions, including, among others, (i) approval of the Merger by an Israeli court (which approval can only occur after the shareholders and, if required, creditors, of Saifun approve the Merger in accordance with Section 350 of the Israeli Companies

**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

**(Unaudited)**

Law), (ii) receipt of certain regulatory and tax approvals, (iii) the absence of any law or order prohibiting the closing, (iv) the accuracy of the representations and warranties of the other party at the time of execution of the Merger Agreement (most of which are subject to an overall material adverse effect qualification), and (v) compliance in all material respects by the other party with its covenants. The Merger is expected to be consummated no later than the first quarter of 2008.

Concurrently with execution of the Merger Agreement, certain affiliates of Saifun entered into Affiliate Agreements pursuant to which such affiliates agreed not to make any sale, transfer or other disposition of Spansion securities that they receive as a result of the Merger in violation of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

Concurrently with entering into the Merger Agreement, certain shareholders of Saifun entered into a Voting Undertaking with Spansion (the Voting Undertakings ) pursuant to which they agreed to vote their shares of Saifun (i) for the adoption and approval of the Merger Agreement and the transactions contemplated thereby, including the Merger (the Transactions ), (ii) against any action or agreement that would compete with, or materially impede, or interfere with or that would reasonably be expected to discourage the Transactions or inhibit the timely consummation of the Transactions, and (iii) except for the Merger, against any alternative business combination transaction, or merger, consolidation, business combination, reorganization, recapitalization, liquidation or sale or transfer of any material assets of the Company or its subsidiaries not permitted pursuant to the Merger Agreement.

Pursuant to the Voting Undertakings, the signing shareholders also agreed that if Saifun terminates the Merger Agreement under certain circumstances, and such shareholders subsequently receive consideration for their Saifun shares in an alternative business combination transaction, then the signing shareholders will pay to Spansion 50 percent of the difference between (i) the sum of the price they would have received in the Merger plus the portion of the cash distribution they would have received from Saifun and (ii) the price they actually receive in the alternative transaction (which payment will take the same form and proportion as the consideration they receive in the alternative transaction).

The Merger Agreement contains certain termination rights for both Spansion and Saifun and further provides that, upon termination of the Merger Agreement under specified circumstances, Saifun may be required to pay Spansion a termination fee of \$8.0 million.

---

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Statements**

*This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), particularly statements regarding our financial outlook for the next twelve months including anticipated future cash flows, long term liquidity, the reasonableness of our critical accounting policies and tax provisions, consummation of anticipated transactions, and the amount of liability exposure related to our indemnities, commitments and guarantees. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, continues, may, will, should, predict, potential and variations of such words and other expressions indicating future results or expectations are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified in Part II, Item 1A, under Risk Factors, and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.*

**Overview**

We are one of the largest Flash memory providers and the largest company in the world exclusively dedicated to designing, developing, manufacturing, marketing and selling Flash memory solutions, a critical semiconductor element of nearly every electronic product and one of the fastest growing segments of the semiconductor industry. Our Flash memory is integrated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, personal computers (PC) and PC peripherals. Our Flash memory solutions are incorporated in products from original equipment manufacturers, or OEMs, in each of these applications, including all of the top ten mobile phone OEMs, all of the top ten consumer electronics OEMs and all of the top ten automotive electronics OEMs. Prior to April 2, 2007, we operated four Flash memory wafer fabrication facilities, or fabs, four assembly and test sites and a development fab, known as our Submicron Development Center, or SDC. We currently operate two Flash memory 200-millimeter wafer fabrication facilities, one in the US and the other in Japan, and have begun producing 300-millimeter development wafers at a third fab, SP1, located in Aizu-Wakamatsu, Japan. Our headquarters are located in Sunnyvale, California.

Our total net sales for the three months ended September 30, 2007 and October 1, 2006 were \$611.1 million and \$674.7 million, respectively. The decrease in the 2007 period compared to the 2006 period was due primarily to a decrease in average selling prices. Our MirrorBit technology represented approximately 71 percent of total net sales for the three months ended September 30, 2007, compared with approximately 53 percent of total sales for the corresponding period of fiscal 2006.

## **Table of Contents**

Our total net sales for the nine months ended September 30, 2007 and October 1, 2006 were \$1,848.0 million and \$1,892.0 million, respectively. The decrease in the 2007 period compared to the 2006 period was due primarily to a decrease in average selling prices. Our MirrorBit technology represented approximately 69 percent of total net sales and 43 percent of total units shipped for the nine months ended September 30, 2007, compared with approximately 45 percent of total sales and 25 percent of total units shipped for the corresponding period of fiscal 2006.

Our net losses for the three and nine months ended September 30, 2007 were \$71.6 million and \$214.0 million, respectively. The benefit for income taxes included in our net losses for the three and nine months ended September 30, 2007 was \$4.3 million and \$18.2 million, respectively.

Our net losses for the three and nine months ended October 1, 2006 were \$22.1 million and \$122.8 million, respectively. The provision for income taxes included in our net losses for the three and nine months ended October 1, 2006 was \$3.0 million and \$1.2 million, respectively.

Our cash and cash equivalents at September 30, 2007, totaled \$260.9 million and consisted of cash, money market funds and commercial paper and our marketable securities totaled \$268.2 million at September 30, 2007. We believe that our anticipated cash flows from operations and current cash balances, our existing credit facilities and access to external financing in the capital markets will be sufficient to fund working capital requirements, capital investments, debt service and operations, and to meet our needs for at least the next twelve months.

Our ability to fund our cash needs over the long term will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive and other factors, such as those discussed in Part II, Item 1A Risk Factors, many of which are beyond our control. Should we require additional funding, such as to satisfy our short-term and long-term debt obligations when due or to make additional capital investments, we may need to raise the required additional funds through additional bank borrowings or public or private sales of debt or equity securities. We cannot assure you that such funding will be available in needed quantities or on terms favorable to us, if at all.

## **Basis of Presentation**

We use a 52- to 53-week fiscal year ending on the last Sunday in December. The three months ended September 30, 2007 and October 1, 2006 both consisted of 13 weeks. The nine months ended September 30, 2007 and October 1, 2006 consisted of 39 weeks and 40 weeks, respectively.

## **Critical Accounting Policies**

Our 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 U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts in our condensed consolidated financial statements. We evaluate our estimates on an on-going basis, including those related to our revenues, allowance for doubtful accounts, inventories, asset impairments, income taxes and pension benefits. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The actual results may differ from these estimates or our estimates may be affected by different assumptions or conditions.

**Table of Contents**

Other than our accounting policy described below regarding accounting for sabbatical, our critical accounting policies, which incorporate our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements, are the same as those described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**Sabbatical Leave Program**

In June 2006, the FASB ratified EITF Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43*. Issue 06-2 provides guidelines under which sabbatical leave or other similar benefits provided to an employee are considered to accumulate. If such benefits are deemed to accumulate, they should be accrued for, as compensation expense over the employee's requisite service period. The provisions of this Issue are effective for fiscal years beginning after December 15, 2006 and allow for either retrospective application or a cumulative effect adjustment approach upon adoption. We adopted this Issue beginning January 1, 2007 using the cumulative effect adjustment approach. The effect of this adoption resulted in an increase to our accumulated deficit of approximately \$10.0 million as of the beginning of fiscal 2007. The effect of this change on our condensed consolidated statements of operations for the three and nine months ended September 30, 2007 is not material.

Our Sabbatical Program provides for eight weeks of paid leave for salaried (exempt) employees in the United States upon the completion of seven years of service. In addition, our Recognition Trip Program provides for one week of paid leave and a fixed cash compensation for hourly (non-exempt) employees in the United States who have completed seven years of service. Prior to the adoption of the Issue, we accounted for the above programs only after the completion of the seven years by the eligible employees because none of the benefits vest or accrete to the employee until completion of the full seven years of service. With the adoption of Issue 06-2, we account for the programs by recording the estimated total program payouts upon attaining the requisite service conditions as compensation expense ratably over each employee's requisite service period.

**Results of Operations****Comparison of Total Net Sales**

The following is a summary of our total net sales for the three and nine months ended September 30, 2007 and October 1, 2006:

	Three Months Ended				Sep. 30, 2007	Nine Months Ended			
	Sep. 30, 2007	Oct. 1, 2006	Variance in Dollars	Variance in Percent		Sep. 30, 2007	Oct. 1, 2006	Variance in Dollars	Variance in Percent
	(in thousands, except percentage)					(in thousands, except percentage)			
Total net sales	\$ 611,069	\$ 674,718	\$ (63,649)	-9%	\$ 1,848,012	\$ 1,891,999	\$ (43,987)	-2%	

**Table of Contents**

Total net sales for the three months ended September 30, 2007 decreased nine percent compared to total net sales for the three months ended October 1, 2006. The decrease was primarily attributable to a 16 percent decrease in average selling prices, partially offset by an eight percent increase in unit shipments. Total net sales for the nine months ended September 30, 2007 decreased two percent compared to total net sales for the nine months ended October 1, 2006. The decrease was primarily attributable to a seven percent decrease in average selling prices, partially offset by a five percent increase in unit shipments. Net sales to the wireless sector and net sales to the consumer, industrial and automotive sectors, were approximately \$316.6 million and \$293.5 million, respectively, for the three months ended September 30, 2007.

**Comparison of Gross Margin, Operating Expenses, Interest and Other Income, Net, Interest Expense and Provision (Benefit) for Income Taxes**

The following is a summary of gross margin; operating expenses; interest and other income (expense), net; interest expense; and provision (benefit) for income taxes for the three and nine months ended September 30, 2007 and October 1, 2006:

	Three Months Ended				Sep. 30, 2007	Nine Months Ended Oct. 1,			
	Sep. 30, 2007	Oct. 1, 2006	Variance in Dollars	Variance in Percent		2006	Variance in Dollars	Variance in Percent	
	(in thousands, except for percentage)					(in thousands, except for percentage)			
Cost of sales	\$ 500,741	\$ 532,563	\$ (31,822)	-6%	\$ 1,541,360	\$ 1,508,848	\$ 32,512	2%	
Gross margin	18%	21%			17%	20%			
Research and development	111,231	89,174	22,057	25%	323,892	262,954	60,938	23%	
Sales, general and administrative	58,226	62,951	(4,725)	-8%	177,027	195,253	(18,226)	-9%	
Operating loss	(59,129)	(9,970)	(49,159)	493%	(194,267)	(75,056)	(119,211)	159%	
Interest and other income, net	6,835	3,888	2,947	76%	27,438	3,741	23,697	633%	
Interest expense	(23,628)	(13,020)	(10,608)	81%	(65,316)	(50,205)	(15,111)	30%	
Provision (benefit) for income taxes	(4,320)	3,013	(7,333)	-243%	(18,163)	1,231	(19,394)	-1575%	

The decrease in gross margin for the three and nine months ended September 30, 2007 was primarily due to the decline in average selling prices as a result of the intense competitive environment in the industry. Gross margin for the three and nine months ended September 30, 2007 included a portion of the gain, approximately \$10.2 million and \$17.2 million, respectively, recognized from the JV1/JV2 Transaction. The total gain from the JV1/JV2 Transaction will be recognized over the term of our Foundry Agreement with Fujitsu.

The increase in research and development expense for the three and nine months ended September 30, 2007 was primarily due to an increase in 300-millimeter development costs at SP1, and the SDC, which together represented approximately 74 percent and 65 percent of the increase for the three and nine months ended September 30, 2007, respectively. Additionally, we incurred higher labor costs primarily due to headcount increases, partially offset by the reduction in development service charges from AMD, which together accounted for approximately 13 percent and 15 percent of the increase for the three and nine months ended September 30, 2007, respectively.

The decrease in sales, general and administrative expense for the three and nine months ended September 30, 2007 was primarily due to lower information technology, legal and other administrative consulting fees. Approximately 76 percent and 65 percent of the decrease for the

**Table of Contents**

three and nine months ended September 30, 2007, respectively, was primarily due to the reduction in outside services as a result of our cost control initiatives in 2007. The decrease was also attributable to the reduction in services provided by AMD. Since fiscal 2006, we have expanded our administrative functions and significantly reduced our reliance on administrative services provided by AMD.

The increase in interest and other income, net for the three months ended September 30, 2007 was primarily due to an increase in interest income as a result of an increase in our invested cash, cash equivalents and marketable securities balances as compared to the same period of fiscal 2006. The increase in interest and other income, net of other expenses for the nine months ended September 30, 2007 was primarily due to a lower loss on early extinguishment of debt of \$3.4 million as a result of repayment of the \$500.0 million Senior Secured Term Loan Facility in the second quarter of fiscal 2007 as compared to the \$17.3 million loss on early extinguishment of debt as a result of the repurchase of the 12.75% Senior Subordinated Notes during the same period of fiscal 2006. The increase for the nine months ended September 30, 2007 was also partially due to a \$7.5 million gain realized on the sale of land in Asia in the second quarter of fiscal 2007 as compared to a \$6.9 million gain on the sale of marketable securities in the second quarter of fiscal 2006. Interest income for the nine months ended September 30, 2007 has also increased due to the combined effect of increases in our invested cash, cash equivalents and marketable securities balances, and an increase in our average investment portfolio yield of approximately 0.5 percent.

The increase in interest expense for the three and nine months ended September 30, 2007 was primarily due to higher average debt balances as compared to the corresponding periods of fiscal 2006, partially offset by amounts that were capitalized related to the build out of SP1. The increase in the debt balance was primarily attributable to a borrowing of \$500.0 million under the Senior Secured Term Loan Facility during the fourth quarter of fiscal 2006, subsequently replaced by the \$625.0 million Senior Secured Floating Rate Notes during the second quarter of fiscal 2007, and a borrowing of \$206.5 million under our Spansion Japan 2007 Credit Facility during the third quarter of fiscal 2007. The increase in interest expense for the nine months ended September 30, 2007 as compared to the same period of fiscal 2006 was partially offset by a decrease of approximately \$8.2 million in the interest expense related to an adjustment to a capital lease obligation during the second quarter of fiscal 2007 and a lower average interest rate on our debt portfolio. The average interest rates were 7.58 percent for the nine months ended September 30, 2007 as compared to 8.49 percent for nine months ended October 1, 2006.

We recorded an income tax benefit of \$4.3 million in the three months ended September 30, 2007 as compared to \$3.0 million of tax expenses in the three months ended October 1, 2006. The income tax benefit recorded in the three months ended September 30, 2007 was primarily due to a \$5.2 million decrease in the valuation allowance associated with deferred tax assets of our Japanese subsidiary, offset by tax provisions of our other foreign subsidiaries of \$0.9 million. This decrease in the valuation allowance was made as we believe that it is more likely than not that these deferred tax assets will be realized. The income tax benefit for the three months ended September 30, 2007 represents the portion of the deferred tax assets that will be recognized in the current year as part of the current year effective tax rate. As part of our projected tax provision for the current year, we anticipate an increase in our valuation allowance against our U.S. deferred tax assets to offset the tax benefits for current year losses in the U.S. The income tax expense recorded in the three months ended October 1, 2006 was primarily due to tax provisions of our foreign subsidiaries of \$1.5 million and the write-off of U.S. deferred tax assets of \$1.5 million that we no longer believed were realizable.



**Table of Contents**

We recorded an income tax benefit of \$18.2 million in the nine months ended September 30, 2007 as compared to \$1.2 million of income tax expense in the nine months ended October 1, 2006. The income tax benefit recorded in the nine months ended September 30, 2007 was primarily due to a decrease of \$21.0 million in the valuation allowance associated with deferred tax assets of our Japanese subsidiary, offset by a tax provision of \$2.8 million of our foreign subsidiaries. During the first quarter of fiscal 2007, we recorded the effect of the change in judgment about the realizability of our Japanese deferred tax assets. This amount included the effect of the change in the beginning of the year balance of the valuation allowance that will be realized in future years, which was recorded during the first quarter. The amount recorded in the nine months ended September 30, 2007 also included the portion of the valuation allowance that will be recognized in the current year as part of the effective tax rate. The income tax expense recorded in the nine months ended October 1, 2006 was primarily due to tax provisions of our foreign subsidiaries of \$4.3 million and the write-off of U.S. deferred tax assets of \$1.5 million that we no longer believed were realizable, partially offset by a benefit from resolution of a tax examination in a foreign jurisdiction of \$4.6 million.

As of September 30, 2007 all of our U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance that was initially established in the fourth quarter of fiscal 2005 upon our conversion to a taxable entity immediately prior to our IPO. The realization of these assets is dependent on substantial future taxable income which at September 30, 2007, in management's estimate, is not more likely than not to be achieved.

***Other Items***

The impact on our operating results from changes in foreign currency exchange rates has not been material, principally because our expenses denominated in yen are generally comparable to our sales denominated in yen, and we enter into foreign currency exchange contracts to mitigate our exposure when yen denominated expenses and sales are not comparable.

As of September 30, 2007, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately \$52.2 million after reduction for estimated forfeitures. Such stock options and RSU awards will generally vest ratably through 2011.

**Table of Contents****Contractual Obligations**

The following table summarizes our contractual obligations as of September 30, 2007, presented on a fiscal year basis.

	Total	2007	2008	2009	2010	2011	2012 and Beyond
	(in thousands)						
<b>Contractual obligations to related party:</b>							
Promissory Note	\$ 500	500	\$	\$	\$	\$	\$
<b>Contractual obligations to third parties:</b>							
Senior Secured Floating Rate Notes	625,000						625,000
Senior Notes	250,000						250,000
Exchangeable Senior Subordinated Debentures	207,000						207,000
Spansion Japan 2007 Credit Facility	206,459		49,550	66,067	90,842		
Capital lease obligations	82,289	6,755	34,614	25,616	8,774	6,530	
Other Credit Facility Subsidiaries	9,223	1,843	7,098	282			
<b>Total principal contractual obligations</b>	<b>1,380,471</b>	<b>9,098</b>	<b>91,262</b>	<b>91,965</b>	<b>99,616</b>	<b>6,530</b>	<b>1,082,000</b>
Operating leases	22,381	4,468	10,989	4,068	1,488	367	1,001
Unconditional purchase commitments	605,856	121,509	288,151	169,058	23,529	3,609	
Interest payments on debt and capital leases	620,757	17,231	95,615	94,107	90,671	89,139	233,994
<b>Total contractual obligations</b>	<b>\$ 2,629,465</b>	<b>\$ 152,306</b>	<b>\$ 486,017</b>	<b>\$ 359,198</b>	<b>\$ 215,304</b>	<b>\$ 99,645</b>	<b>\$ 1,316,995</b>

**Spansion Japan 2007 Credit Facility**

On March 30, 2007, Spansion Japan entered into a committed senior facility agreement with certain Japanese financial institutions that provide Spansion Japan with an up to 48.4 billion yen senior secured term loan facility (approximately \$421.6 million as of September 30, 2007).

Spansion Japan may, pursuant to the terms of this facility, borrow amounts in increments of 1.0 billion yen (approximately \$8.7 million as of September 30, 2007). Amounts borrowed under this facility bear interest at a rate equal to the Japanese yen three month Tokyo Interbank Offered Rate, or Japanese yen TIBOR, at the time of the drawdown, plus a margin of two percent per annum, which will reset quarterly. Borrowing availability is based on capital deliveries for Spansion Japan's SPI facility.

Pursuant to the terms of Spansion Japan 2007 Credit Facility, Spansion Japan is not permitted, among other things, to create any security interests or liens on any of its pledged assets and to sell or dispose of any of its pledged assets, subject to certain exceptions including the sale of JV1/JV2. This facility may be terminated in the event of default in accordance with the terms of this facility. Events of default under the facility include, among other things, the following: a default in performance of payment; if any of debt obligations of Spansion LLC exceeding \$25.0 million, or of Spansion Japan exceeding 1.0 billion yen, are not paid when due; or if any debt obligations of Spansion Japan or Spansion LLC are accelerated or otherwise become due and payable, in each case if not cured within applicable time periods set forth in the Spansion Japan 2007 Credit Facility.

As of September 30, 2007, the outstanding balance under this facility is 23.7 billion yen (approximately \$206.5 million). This amount bears interest at approximately 2.84 percent and 80 percent of the balance will be repaid in equal, consecutive, quarterly principal installments starting from the second quarter of fiscal 2008 through the third quarter of fiscal 2010 and the remaining balance will be paid in the fourth quarter of fiscal 2010.

**Senior Secured Floating Rate Notes**

In May 2007, Spansion LLC, our wholly owned operating company subsidiary, issued \$625.0 million aggregate principal amount of the Senior Secured Floating Rate Notes due 2013.



---

**Table of Contents**

Interest on the Notes accrues at a rate per annum, reset quarterly, equal to the 3-month London Interbank Offered Rate plus 3.125 percent. Interest is payable on March 1, June 1, September 1 and December 1 of each year beginning September 1, 2007 until the maturity date of June 1, 2013. As of September 30, 2007, the Notes bear interest at approximately 8.82 percent.

In connection with the issuance of the Notes, we, Spansion LLC and Spansion Technology Inc., executed a pledge and security agreement, pursuant to which and subject to exceptions specified therein, the Notes are secured by a first priority lien on all of Spansion LLC's inventory (excluding returned inventory), equipment and real property and proceeds thereof (excluding receivables or proceeds arising from sales of inventory in the ordinary course of business), presently owned or acquired in the future by Spansion LLC and by each of the current and any future guarantors. The Notes are also secured by a second-priority lien that is junior to the liens securing Spansion LLC's Revolving Credit Agreement dated as of September 19, 2005, as amended, on substantially all other real and personal property and proceeds thereof, including receivables or proceeds arising from sales of inventory in the ordinary course of business presently owned or acquired in the future by us and by each of the current and any future guarantors. The Notes are further secured by certain deeds of trust related to real property owned by Spansion LLC in California and Texas.

Holders of the Notes may require Spansion LLC to repurchase the Notes for cash equal to 101 percent of the aggregate principal amount to be repurchased plus accrued and unpaid interest upon the occurrence of a change of control of Spansion LLC. Beginning June 1, 2008, Spansion LLC may redeem all or any portion of the Notes, at any time or from time to time at redemption prices specified therein. Prior to June 1, 2008, Spansion LLC may redeem up to 35 percent of the Notes from the proceeds of certain equity offerings at a redemption price of 100 percent.

Certain events are considered Events of Default, which may result in the accelerated maturity of the Notes, including:

Spansion LLC's failure to pay when due the principal or premium amount on any of the Notes at maturity, upon acceleration, redemption, optional redemption, required repurchase or otherwise;

Spansion LLC's failure to pay interest on any of the Notes for 30 days after the date when due;

Spansion LLC's or the Guarantors' failure to comply with certain restrictions on Spansion LLC's or Guarantors' ability to merge, consolidate or sell substantially all of its assets;

Spansion LLC's failure to perform or observe any other covenant or agreement in the Notes or in the Indenture for a period of 45 days after receiving notice of such failure;

A default by Spansion LLC or any restricted subsidiary (as defined in the Indenture) under any indebtedness that results in acceleration of such indebtedness, or the failure to pay any such indebtedness at maturity, in an aggregate principal amount in excess of \$50.0 million (or its foreign equivalent at the time);

If any judgment or judgments for the payment of money in an aggregate amount in excess of \$50.0 million (or its foreign equivalent at the time) is rendered against Spansion LLC, the Guarantors or any significant subsidiary and is not waived, satisfied or discharged for any period of 60 consecutive days during which a stay of enforcement is not in effect;

---

**Table of Contents**

Certain events of bankruptcy, insolvency or reorganization with respect to Spansion LLC or any significant subsidiary;

If any note guaranty ceases to be in full force and effect, other than in accordance with the terms of the Indenture, or a Guarantor denies or disaffirms its obligations under its note guaranty, other than in accordance with the terms of the Indenture; or

Any lien securing the collateral underlying the Notes at any time ceases to be in full force and effect, and does not constitute a valid and perfected lien on any material portion of the collateral intended to be covered thereby, if such default continues for 30 days after notice.

**Other Financial Matters**

***JV1/JV2 Transaction***

On April 2, 2007, Spansion Japan closed the JV1/JV2 Transaction (the *JV1/JV2 Transaction*) pursuant to the Asset Purchase Agreement dated as of September 28, 2006. Under the terms of the Asset Purchase Agreement, Spansion Japan sold two wafer fabrication facilities located in Aizu-Wakamatsu, Japan (the *JV1/JV2 Facilities*), to Fujitsu together with selected manufacturing equipment, inventory and other tangible assets located at the JV1/JV2 Facilities and received proceeds of approximately \$170.0 million in cash from Fujitsu in April 2007. In conjunction with the Transaction on April 2, 2007, Spansion Japan also sold certain equipment located at the JV1/JV2 Facilities to an unrelated third party Japanese corporation for approximately \$24.0 million, which is leasing the equipment to Fujitsu.

The total gain from the JV1/JV2 Transaction, which was the difference between the sales proceeds and the net book value of the assets sold under the terms of the agreement, was approximately \$72.5 million as of April 2, 2007. We accounted for the JV1/JV2 Transaction in accordance with FASB Statement No. 66, *Accounting for Sales of Real Estate* as a sale of real estate that included property improvements and integral equipment because the building was subject to an existing lease of the underlying land. We determined that continuing involvement existed with Fujitsu under the Foundry Agreement effective until December 2009 and, accordingly, will recognize the gain over the term of the Foundry Agreement with Fujitsu (i.e., over the period of continuing involvement). See Note 6 for details of the JV1/JV2 Transaction and the related agreements that Spansion Japan entered into with Fujitsu.

***Merger Agreement with Saifun Semiconductors Ltd. ( Saifun )***

On October 8, 2007, we and Saifun entered into an Agreement and Plan of Merger and Reorganization, dated as of October 7, 2007 (the *Merger Agreement*), pursuant to which Atlantic Star Merger Sub Ltd., a wholly owned subsidiary of us would merge (the *Merger*) with and into Saifun, with Saifun surviving as our wholly owned subsidiary.

Subject to the terms and conditions of the Merger Agreement, which has been approved by the boards of directors of both companies, each Saifun shareholder will receive 0.7429 shares of our Class A common stock and approximately \$5.05 per share in cash (representing a distribution of approximately \$158.3 million of Saifun's existing cash to all holders of record immediately prior to the consummation of the merger) for each Saifun Ordinary Share. Saifun's stock options will convert upon completion of the Merger into stock options with respect to our common stock, after giving effect to the exchange ratio in the Merger and the cash distribution.

---

**Table of Contents**

The Merger is expected to be consummated no later than the first quarter of 2008. See Note 11 for details of the merger agreements.

***Liquidity and Capital Resources***

Our cash and cash equivalents at September 30, 2007 totaled \$260.9 million and consisted of cash, money market funds and commercial paper, and our marketable securities totaled \$268.2 million at September 30, 2007. We are subject to restrictions on our distribution of cash contained in our third-party loan agreements described under the Contractual Obligations section above and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission on February 27, 2007.

***Net Cash Provided by Operating Activities***

Net cash provided by operating activities was \$181.7 million in the nine months ended September 30, 2007. Non-cash charges or benefits included in the net loss consisted primarily of \$387.7 million of depreciation and amortization, benefit for deferred income taxes of \$43.5 million and compensation cost recognized under stock plans of \$12.1 million. The net changes in operating assets and liabilities in the nine months ended September 30, 2007 were primarily attributable to an increase in inventory of \$76.6 million in anticipation of increased seasonal demand in the fourth quarter of the year; a decrease in accounts receivable of \$48.3 million primarily as a result of the improvement in the days sales outstanding; an increase in prepaid expenses and other current asset of \$28.0 million primarily due to an increase in consumption tax refund receivable related to capital expenditures for the build out of SP1; an increase in other assets of \$21.6 million primarily as a result of increases in capitalized financing costs associated with our Spansion Japan 2007 Credit Facility and issuance of our Senior Secured Term Loan Facility; an increase in accounts payable and accrued liabilities of \$110.9 million primarily due to our capital expenditures for SP1; and an increase in income taxes payable of \$19.0 million primarily due to the gain from the JV1/JV2 Transaction in the second quarter of fiscal 2007.

Net cash provided by operating activities was \$284.6 million in the nine months ended October 1, 2006. Non-cash charges included in the net loss consisted primarily of \$407.0 million of depreciation and amortization, loss on debt extinguishment of \$17.3 million and compensation cost recognized under stock plans of \$19.8 million. The net changes in operating assets and liabilities in the nine months ended October 1, 2006 were primarily attributable to an increase in prepaid expenses and other current assets of \$10.5 million, an increase in inventories of \$6.7 million and a decrease in income taxes payable of \$11.4 million, partially offset by a decrease in accounts receivable of \$4.7 million, and an increase in deferred income on shipments of \$3.9 million compared to December 25, 2005.

***Net Cash Used in Investing Activities***

Net cash used in investing activities was \$918.3 million in the nine months ended September 30, 2007, of which \$964.7 million related to acquisition of property, plant and equipment, primarily for our 300-millimeter development and technology facilities, SP1 and SDC, and \$142.2 million of net cash used in the purchase of marketable securities, offset in part by a cash proceeds of \$188.5 million from sale of property, plant and equipment, primarily from the JV1/JV2 Transaction.

---

**Table of Contents**

Net cash used in investing activities was \$248.3 million in the nine months ended October 1, 2006, primarily as a result of \$470.8 million used to purchase property, plant and equipment and a cash outflow of \$63.6 million for the purchase of marketable securities, offset in part by a cash inflow of \$282.6 million from the maturity and sale of marketable securities.

***Net Cash Used in Financing Activities***

Net cash provided by financing activities was \$251.1 million in the nine months ended September 30, 2007, primarily as a result of \$831.0 million of proceeds from the issuance of Senior Secured Floating Rate Notes, net of issuance costs, and borrowing under our Spansion Japan 2007 Credit Facility, offset in part by \$580.0 million in payments on debt and capital lease obligations, \$500.0 million of which constituted repayment and early extinguishment of the Senior Secured Term Loan Facility.

Net cash used in financing activities was \$175.6 million in the nine months ended October 1, 2006. This amount included \$527.1 million in payments on debt and capital lease obligations, including \$197.1 million in payments to AMD, of which \$175.0 million was used to repurchase Spansion LLC's 12.75% Senior Subordinated Notes, and \$7.2 million in payments to AMD for stock-based compensation, offset in part by a cash inflow of \$329.0 million of proceeds from borrowings, net of issuance costs, of which approximately \$204.0 million was from the issuance of Spansion LLC's 2.25% Exchangeable Senior Subordinated Debentures in the second quarter of fiscal 2006, and \$29.8 million of proceeds received from equipment sale-leaseback transactions.

Our future uses of cash will primarily be for working capital, capital expenditures, debt service and other contractual obligations. Our capital expenditures during the nine months ended September 30, 2007 were \$964.7 million, and we expect to spend approximately \$35 million on capital expenditures during the remainder of fiscal 2007, depending upon timing of capital deliveries during the fourth quarter of fiscal 2007.

The total amount due on debt service and other contractual obligations during the remainder of fiscal 2007 is approximately \$152.3 million. We have \$207.0 million in outstanding 2.25% Exchangeable Senior Subordinated Debentures due 2016 which are exchangeable for shares of our Class A common stock, cash or a combination of cash and shares of such Class A common stock, at our option. At any time prior to maturity, we may make an irrevocable election to satisfy the exchange obligation in cash up to 100 percent of the principal amount of the debentures exchanged, with any remaining amount to be satisfied in shares of Class A common stock or a combination of cash and shares of Class A common stock at a certain exchange ratio. We have not made the election and no debentures have been exchanged for our Class A common stock or cash as of September 30, 2007.

As of September 30, 2007, we had cash and cash equivalents of \$260.9 million, marketable securities of \$268.1 million and \$183.5 million available under our credit facilities, totaling \$712.5 million.

The availability under our credit facilities is subject to certain borrowing base limitations and other covenants.

## **Table of Contents**

We believe that our anticipated cash flows from operations and current cash balances, our existing credit facilities and access to external financing in the capital markets will be sufficient to fund working capital requirements, capital investments, debt service and operations and to meet our needs for at least the next twelve months.

Our ability to fund our cash needs over the long term will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive and other factors, such as those discussed in Part II, Item 1A Risk Factors, many of which are beyond our control. Should we require additional funding, such as to satisfy our short-term and long-term debt obligations when due or to make additional capital investments, we may need to raise the required additional funds through additional bank borrowings or public or private sales of debt or equity securities. We cannot assure you that such funding will be available in needed quantities or on terms favorable to us, if at all.

### ***Off-Balance-Sheet Arrangements***

During the normal course of business, we may provide certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities include non-infringement of patents and intellectual property indemnities to our customers in connection with the delivery, design, manufacture and sale of our products, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to other parties to certain acquisition agreements, such as under the JV1/JV2 Transaction. The duration of these indemnities, commitments and guarantees varies, and in certain cases, is indefinite. We believe that substantially all of our indemnities, commitments and guarantees provide for limitations on the maximum potential future payments we could be obligated to make. However, we are unable to estimate the maximum amount of liability related to our indemnities, commitments and guarantees because such liabilities are contingent upon the occurrence of events which are not reasonably determinable. We believe that any liability for these indemnities, commitments and guarantees would not be material to our accompanying condensed consolidated financial statements.

### ***Proposed FASB Accounting Changes for Convertible Debt***

At the July 25, 2007 FASB meeting, the FASB agreed to issue for comment a proposed FASB Staff Position (FSP) addressing convertible instruments that may be settled in cash upon conversion (including partial cash settlement). This proposed FSP would address instruments commonly referred to as Instrument C from EITF Issue No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* (Issue 90-19). Those instruments essentially require the issuer to settle the principal amount in cash and the conversion spread in cash or net shares at the issuer's option. The proposed FSP would also address any other convertible debt instruments that allow settlement in any combination of cash and shares at the issuer's option. The proposed FSP would require the issuer to separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost and would also require bifurcation of a component of the debt, classification of that component in equity, and then accretion of the resulting discount on the debt to result in the economic interest cost being reflected in the income statement. The Board members emphasized the need for clarity around the term economic interest cost in the proposed FSP.



---

**Table of Contents**

In June 2006, Spansion LLC, our wholly owned subsidiary, issued \$207.0 million of aggregate principal amount of 2.25% Exchangeable Senior Subordinated Debentures due 2016 ( Exchangeable Debt ). Our accounting of the Exchangeable Debt is likely to be impacted by the proposed FSP as the related indenture provides us with the option to settle some or all of the instrument in cash. In its current form, the proposed FSP would make any final guidance effective for fiscal periods beginning after December 15, 2007, would not permit early application, and would be applied retrospectively to all periods presented (retroactive restatement) pursuant to the guidance in FASB Statement No. 154, *Accounting Changes and Error Corrections*. We are currently evaluating the impact of the proposed FSP and any changes prior to its effective date. However, this change will not impact the amount of cash payments for interest nor our future cash flows.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Reference is made to Part II, Item 7A, *Quantitative and Qualitative Disclosures about Market Risk* in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. We experienced no significant changes in market risk during the first nine months of fiscal 2007 except as follows: during the first nine months of fiscal 2007, the U.S. dollar weakened against the Japanese yen. As a result, the cumulative translation adjustment balance has increased. This increase was primarily due to the translation of net assets of our subsidiary in Japan, denominated in that entity's functional currency, the Japanese yen, into our reporting currency, the U.S. dollar. However, this translation adjustment does not affect our earnings or cash flows as it is recorded as a component of stockholders' equity in our balance sheet. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to continue to incur foreign currency translation adjustments, which will either increase or decrease our total stockholders' equity balance and which may be material. In addition, we cannot give any assurance as to the effect of future changes in foreign currency rates on our consolidated financial position, results of operations or cash flows.

**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 at the reasonable assurance level 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 to Internal Control over Financial Reporting***

There were no changes to our internal control over financial reporting identified in connection with our management's evaluation that occurred during the third quarter of fiscal 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

***Tessera, Inc. v. Spansion LLC, et al., Civil Action No. 05-04063 (CW), in the United States District Court for the Northern District of California***

On October 7, 2005, Tessera, Inc. filed a complaint, Civil Action No. 05-04063, for patent infringement against Spansion LLC in the United States District Court for the Northern District of California under the patent laws of the United States of America, 35 U.S.C. section 1, *et seq.*, including 35 U.S.C. section 271. The complaint alleges that Spansion LLC's Ball Grid Array ( BGA ) and multichip packages infringe the following Tessera patents: United States Patent No. 5,679,977, United States Patent No. 5,852,326, United States Patent No. 6,433,419 and United States Patent No. 6,465,893. On December 16, 2005, Tessera filed a First Amended Complaint naming Spansion Inc. and Spansion Technology Inc., our wholly owned subsidiary, as defendants. On January 31, 2006, Tessera filed a Second Amended Complaint adding Advanced Semiconductor Engineering, Inc., Chipmos Technologies, Inc., Chipmos U.S.A., Inc., Silicon Precision Industries Co., Ltd., Siliconware USA, Inc., ST Microelectronics N.V., ST Microelectronics, Inc., Stats Chippac Ltd., Stats Chippac, Inc., and Stats 34 Chippac (BVI) Limited. The Second Amended Complaint alleges that Spansion LLC's BGA and multichip packages infringe the four Tessera patents identified above. The Second Amended Complaint further alleges that each of the newly named defendants is in breach of a Tessera license agreement and is infringing on a fifth Tessera patent, United States Patent No. 6,133,627. The Second Amended Complaint seeks unspecified damages and injunctive relief. On February 9, 2006, Spansion filed an answer to the Second Amended Complaint and asserted counterclaims against Tessera. On April 18, 2006, U.S. District Court Judge Claudia Wilken issued a Case Management Order that set a trial date of January 28, 2008. On March 13, 2007, Judge Wilken issued an order vacating the trial date. On April 12, 2007, Judge Wilken issued an order referring case management scheduling issues to a Special Master, and directing that the court will appoint an expert in the case to testify on the ultimate merits of the technical issues relating to infringement and patent validity. On April 26, 2007, Spansion, along with other defendants, filed a motion to stay the District Court action pending resolution of the proceeding before the International Trade Commission described below. On May 24, 2007, Judge Wilken issued an order staying the District Court action until final resolution of the ITC action.

Tessera has requested the following findings and remedies in this District Court action:

a finding that Tessera's patents are valid and enforceable and that we are deliberately and willfully infringing Tessera's patents;

injunctive relief prohibiting us from engaging in any further conduct that would infringe Tessera's patents;

An award to Tessera to recover all damages, including interest on damages, from the alleged infringement;

An award of treble damages for deliberate and willful conduct;

a finding that the case is exceptional, in which case attorney fees should be awarded to the prevailing party; and

An unspecified award of attorneys' fees and costs.

---

**Table of Contents**

We believe that we have meritorious defenses against Tessera's claims and we intend to defend the lawsuit vigorously.

***In the Matter of Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same, in the United States International Trade Commission***

On April 17, 2007, Tessera, Inc. filed a complaint under section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337, in the United States International Trade Commission against respondents ATI Technologies, Inc., Freescale Semiconductor, Inc., Motorola, Inc., Qualcomm, Inc., Spansion Inc., Spansion LLC and STMicroelectronics N.V. Tessera claims that face up and stacked-chip small format laminate Ball Grid Array (BGA) packages, including the Spansion 5185941F60 chip assembly, infringe certain specified claims of United States Patent Nos. 5,852,326 and 6,433,419 (the Asserted Patents). The complaint requests that the International Trade Commission institute an investigation into the matter.

Tessera has requested the following relief in the International Trade Commission action:

a permanent exclusion order pursuant to section 337(d) of the Tariff Act of 1930, as amended, excluding from entry into the United States all semiconductor chips with small format laminate BGA semiconductor packaging that infringe any of the Asserted Patents, and all products containing such infringing small format laminate BGA semiconductor packaged chips; and

a permanent cease and desist order pursuant to section 337(f) of the Tariff Act of 1930, as amended, directing respondents with respect to their domestic inventories to cease and desist from marketing, advertising, demonstrating, sampling, warehousing inventory for distribution, offering for sale, selling, distributing, licensing, or using any semiconductor chips with small format laminate BGA semiconductor packaging that infringe any of the Asserted Patents, and/or products containing such semiconductor chips.

On May 15, 2007, the International Trade Commission instituted an investigation pursuant to 19 U.S.C. § 1337, entitled *In the Matter of Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-605. On June 8, 2007, the respondents in this matter filed a motion to stay the International Trade Commission investigation pending reexamination of the Asserted Patents by the U.S. Patent and Trademark Office. On July 11, 2007, the administrative law judge ordered that an Initial Determination shall be due on May 21, 2008 and that a target date for completion of the investigation shall be August 21, 2008. On October 17, 2007, the International Trade Commission investigation was reassigned to Administrative Law Judge Theodore Essex.

We believe that we have meritorious defenses against Tessera's claims and we intend to defend this proceeding vigorously.

---

**Table of Contents**

**ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk and these risks may impact the forward-looking statements described elsewhere in this 10-Q. You should carefully consider the risks described below and the other information in this quarterly report. If any of the following risks occur, our business could be materially harmed, and our financial condition and results of operations could be materially and adversely affected. As a result, the price of our common stock could decline, and you could lose all or part of your investment.*

*The demand for our products depends in large part on continued growth in the industries into which they are sold. A decline in the markets served by any of these industries, or a decline in demand for Flash memory products in these industries, would have a material adverse effect on our results of operations.*

Sales of our Flash memory products are dependent to a large degree upon consumer demand for mobile phones. In fiscal 2006 and during the first nine months of fiscal 2007, wireless customers, who primarily consist of mobile phone original equipment manufacturers, or OEMs, represented the largest market for NOR Flash memory. The market research firm iSuppli projects that wireless handset NOR Flash memory will represent approximately 78 percent of all NOR Flash memory sales in 2007, excluding commercial die such as the DRAM that is bundled in our multi-chip packages (MCPs). In fiscal 2006 and fiscal 2005 and the first nine months of fiscal 2007, sales to wireless Flash memory customers drove a majority of our sales.

Similarly, sales of our products targeting embedded Flash memory customers are dependent upon demand for consumer electronics such as set top boxes, or STBs, and DVD players, automotive electronics, industrial electronics such as networking equipment, personal computers (PC) and PC peripheral equipment such as printers. Sales of our products are also dependent upon the inclusion of increasing amounts of Flash memory content in some of these products. In fiscal 2006 and the first nine months of fiscal 2007, sales to embedded Flash memory customers drove a significant portion of our sales.

If demand for mobile phones or products in the embedded portion of the integrated category of the Flash memory market, or the Flash memory content of these products, is below our or analysts' expectations, if the functionality of successive generations of such products does not require increasing Flash memory density or if such products no longer require Flash memory due to alternative technologies or otherwise, we would be materially adversely affected.

*Our business has been characterized by average selling prices that decline over time, which can negatively affect our results of operations.*

Historically, average selling prices of our products have decreased during the products' lives, and we expect this trend to continue. When our average selling prices on existing products decline, our net sales and gross margins also decline unless we are able to compensate by selling more units, reducing our manufacturing costs or introducing and selling new, higher margin products with higher densities and/or advanced features. If average selling prices for our products decline, our operating results could be materially adversely affected.

Moreover, during downturns, periods of extremely intense competition, or the presence of oversupply in the industry, average selling prices for our products have declined at an unexpectedly high rate over relatively short time periods. For example during the second quarter of fiscal 2007, our average selling prices decreased by approximately 11 percent compared with the first quarter of fiscal 2007 due to unanticipated intense competitive pricing environments in the Flash memory market that were greater than expected. We are unable to predict average selling prices for any future periods and may experience unanticipated, sharp declines in average

---

**Table of Contents**

selling prices for our products. When such unexpected pricing degradations occur, we may not be able to mitigate the effects by selling more or higher margin units, or by reducing our manufacturing costs. In such circumstances, our operating results could be materially adversely affected.

***We have lost rights to key intellectual property arrangements because we are no longer a beneficiary of AMD's patent cross-license agreements and other licenses, which creates a greatly increased risk of patent or other intellectual property infringement claims against us.***

As a subsidiary of AMD until our initial public offering in December 2005, we were the beneficiary of AMD's intellectual property arrangements with third parties, including patent cross-license agreements with other major semiconductor companies such as Intel, Motorola and IBM, and licenses from third parties for technology incorporated in our products and software used to operate our business. As a result of the conversion of the outstanding shares of Class D common stock into shares of Class A common stock in November 2006, we ceased to be a beneficiary under most of the remainder of these license agreements. As a result, we may be subject to claims that we are infringing intellectual property rights of third parties through the manufacture and sale of our products and the operation of our business. Therefore, absent negotiating our own license agreements with the third parties who own such intellectual property, we will be vulnerable to claims by such parties that our products or operations infringe such parties' patents or other intellectual property rights.

We will continue to attempt to negotiate our own agreements and arrangements with third parties for intellectual property and technology that are important to our business, including the intellectual property that we previously had access to through our relationship with AMD. We will also continue to attempt to acquire new patents as our success in negotiating patent cross-license agreements with other industry participants will depend in large part upon the strength of our patent portfolio relative to that of the third party with which we are negotiating. If such third-party benefits from an existing patent cross-license agreement with AMD or Fujitsu, in many cases such third party will retain the rights that it has under that agreement, including rights to utilize the patents that AMD and Fujitsu transferred to us in connection with our reorganization as Spansion LLC in June 2003. In many cases, third parties also retain such rights to utilize any patents that have been issued to us or acquired by us between the dates of our reorganization in 2003 and our initial public offering in 2005 or, in some cases, between the dates of our reorganization in 2003 and the conversion of the Class D common stock in 2006. Our negotiating position will therefore be impaired, because the other party will already be entitled to utilize a large number of our patents, while we will no longer have the right to utilize that party's patents. As a result, we may be unable to obtain access to the other party's patent portfolio on favorable terms or at all. Similarly, with respect to licenses from third parties for technology incorporated in our products or software used to operate our business, we may not be able to negotiate prices with these third parties on terms as favorable to us as those previously available to us because we are not able to take advantage of AMD's size and purchasing power. These parties, and other third parties with whom AMD had no prior intellectual property arrangement, may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted. Such litigation could be extremely expensive and time consuming. We cannot assure you that such litigation would be avoided or successfully concluded. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture or sale of some or all of our products, would have a material adverse effect on us.

---

**Table of Contents**

*The Flash memory market is highly cyclical and has experienced severe downturns that have materially adversely affected, and may in the future materially adversely affect, our business.*

The Flash memory market is highly cyclical and has experienced severe downturns, often as a result of wide fluctuations in supply and demand, constant and rapid technological change, continuous new product introductions and price erosion. Our financial performance has been, and may in the future be, adversely affected by these downturns. We have incurred substantial losses in past downturns, due principally to:

substantial declines in average selling prices, particularly due to aggressive pricing by competitors and an imbalance in product supply and demand;

a decline in demand for end-user products that incorporate our products; and

less than expected demand in the distribution channels such as by mobile phone OEMs.

For example, during the first quarter of fiscal 2007, our business was adversely affected by a seasonal drop in unit shipments, and during the first nine months of fiscal 2007 our business was adversely affected by a greater than average seasonal decline in average selling prices as a result of intense competitive pressures. Our historical financial information does not necessarily indicate what our results of operations, financial condition or cash flows will be in the future. If our net sales decline in the future, or if these or other similar conditions continue or occur again in the future, we would likely be materially adversely affected.

*If our expense reduction efforts are not effective, our business could be materially adversely affected.*

We incurred net losses in each of fiscal 2006, 2005 and 2004 of approximately \$148.0 million, \$304.0 million and \$20.0 million, respectively, and in the first nine months of fiscal 2007 we incurred a net loss of approximately \$214.0 million. As a result, we continue to undertake actions in an effort to significantly reduce our expenses, including our goal to reduce \$50.0-100.0 million in 2007 planned expenses. These actions include the sale of non-performing assets, the consolidation of certain functional operations and other activities related to reducing expenses. We cannot assure you that we will be able to achieve anticipated expense reductions. If our expense reduction efforts are unsuccessful, we may be materially adversely affected.

*Although we expect that the merger with Saifun will result in benefits to us, those benefits may not occur because of integration and other challenges.*

If the merger is completed, achieving the expected benefits of the merger will depend on the timely and efficient integration of our and Saifun's technology, operations, business culture and personnel. This will be particularly challenging due to the fact that Saifun is headquartered in Israel and we are headquartered in California. The integration may not be completed as quickly as expected, and if we fail to effectively integrate the companies or the integration takes longer than expected, we may not achieve the expected benefits of the merger. The challenges involved in this integration include, among others:

retaining the licensees and customers of both companies, including licensees and customers of Saifun who may compete with us;

retaining the main sources of supply of both companies;

incorporating Saifun's technology into our current and future technology and product lines;

integrating Saifun's sales force into our worldwide sales network;



**Table of Contents**

demonstrating to Saifun's licensees and customers that the merger will not result in adverse changes in pricing, customer service standards or support;

coordinating research and development activities to enhance introduction of new products and technologies;

integrating Saifun's internal control over financial reporting with our internal control over financial reporting;

migrating Saifun to our information systems;

integrating Saifun's engineering operations with ours;

persuading the employees of both companies that the companies' business cultures are compatible;

maintaining employee morale and retaining key employees;

ensuring there are no delays in releasing new products and technologies to market; and

coordinating geographically separate organizations.

This integration effort will be international in scope, complex, time consuming and expensive, and may disrupt the respective businesses or result in the loss of licensees, customers or key employees or the diversion of the attention of management. In addition, the integration process may strain our financial and managerial controls and reporting systems and procedures. This may result in the diversion of management and financial resources from our core business objectives. There can be no assurance that we and Saifun will successfully integrate their respective businesses or that we will realize the anticipated benefits of the merger. If we do not realize the anticipated benefits of the merger, or if charges and other accounting changes resulting from the merger adversely affect our earnings, the merger could result in a reduction of our per-share earnings as compared to the per-share earnings that would have been achieved by us if the merger had not occurred. Also, if Saifun shareholders sell the Spansion Class A common stock received in the merger immediately, such sales could cause a decline in the market price of our Class A common stock.

***If we complete the merger with Saifun, political, economic and military conditions in Israel may adversely affect our business.***

Saifun's headquarters and business operations are located in Israel, which is affected and surrounded by unstable political, economic and military conditions. We cannot predict the effect of continued or increased violence in Lebanon or Gaza, or the effect of military action elsewhere in the Middle East. Continued armed conflicts or political instability in the region would harm business conditions and could adversely affect the combined company's results of operations. Furthermore, several countries continue to restrict or ban business with Israel and Israeli companies. These restrictive laws and policies may limit the combined company's ability to make sales in those countries, and, as a global company, may limit our own ability to efficiently administer our worldwide resources.

***The proposed merger may result in a loss of licensees or customers.***

We and Saifun operate in a highly competitive industry, and the combined company's future performance will be affected by its ability to retain each company's existing licensees and customers. Some of Saifun's licensees and customers are our competitors or work with our competitors and may reduce or terminate their business relationships with Saifun in anticipation of the merger or with the combined company as a result of the merger.

***We may not realize the expected value of Saifun's NROM technology.***



## Edgar Filing: Spansion Inc. - Form 10-Q

We expect that licensees of Saifun's NROM technology will continue to implement and expand their uses of the technology. If such licensees fail to successfully implement the NROM technology in a timely manner or in a large number of their products, the value of NROM technology could be diminished. Moreover, if leading Flash memory semiconductor manufacturers adopt and achieve success with other technologies or incorporate Saifun's NROM technology but fail to achieve success with its products, the value of the NROM technology could be adversely affected.

In addition, we cannot assure you that Saifun's patents, including ones covering NROM technology, would not be challenged, invalidated or circumvented, or that rights granted under these patents will provide a competitive advantage to us. If Saifun's patents are ultimately challenged, invalidated or circumvented, we may be materially adversely affected.

***Our business may be adversely affected if our merger with Saifun is delayed or not completed.***

Our merger with Saifun is subject to several customary conditions, including obtaining clearance from governmental entities and the approvals of the transaction by Saifun's

**Table of Contents**

shareholders. If our merger with Saifun is delayed or not consummated, we could be subject to a number of risks that may adversely affect our business, including:

the adverse consequences resulting from our management's attention having been diverted from our day-to-day business over an extended period of time;

the disruption to our relationships with customers, suppliers and partners as a result of our and their efforts relating to the merger;

any consequent potential loss of business to our competitors;

the significant costs and expenses that we may have incurred relating to the merger; and

our inability to realize the benefits we expect by merging with Saifun.

We cannot assure you that we will successfully complete our merger with Saifun, and any inability to successfully complete, or a delay in completing, the Saifun merger could have a material adverse effect on us.

***A significant market shift to NAND architecture would materially adversely affect us.***

Flash memory products are generally based on either NOR or NAND architecture. To date, our Flash memory products have been based on NOR architecture which are typically produced at a higher cost-per-bit than NAND-based products. We do not currently manufacture products based on NAND architecture. We have developed our MirrorBit ORNAND, MirrorBit Quad and MirrorBit Eclipse architectures to address certain portions of the integrated category of the Flash memory market served by NAND-based products, but we cannot be certain that our MirrorBit ORNAND-, Quad- or Eclipse- based products will satisfactorily address those market needs.

During 2004, industry sales of NAND-based Flash memory products grew at a higher rate than sales of NOR-based Flash memory products, resulting in NAND vendors in aggregate gaining a greater share of the overall Flash memory market and NOR vendors in aggregate losing overall market share. This trend continued in 2005 and 2006 when sales of NAND-based Flash memory products represented a majority of the Flash memory products sold in the Flash memory market. In 2006, according to iSuppli, total sales for the Flash memory market reached approximately \$20.7 billion, of which approximately 40 percent was classified as sales of NOR-based Flash memory products and approximately 60 percent was classified as sales of NAND-based Flash memory products. We expect the trend of decreasing market share for NOR-based Flash memory products to continue in the future. iSuppli estimates that sales of NAND-based Flash memory products grew by approximately 15 percent from 2005 to 2006 and will grow at a 13 percent compound annual growth rate from 2006 to 2011, while sales of NOR-based Flash memory products grew by approximately six percent from 2005 to 2006 and will grow at one percent compound annual growth rate from 2006 to 2011.

Moreover, the removable storage category of the Flash memory market, which is predominantly served by floating gate NAND vendors, is expected to constitute a significant portion of the Flash memory market for the foreseeable future. As mobile phones and other consumer electronics become more advanced, they will require higher density Flash memory to meet the increased data storage requirements associated with music downloads, photos and videos. Because storage requirements will increase to accommodate data-intensive applications, OEMs may increasingly choose higher density floating gate NAND-based Flash memory products over MirrorBit NOR-, ORNAND-, Quad- or Eclipse-based Flash memory products for their applications. If this occurs and OEMs continue to prefer the attributes and characteristics of floating gate NAND-based products over those of MirrorBit NOR-, ORNAND-, Quad- or Eclipse-based products for their applications, we may be materially and adversely affected.

---

**Table of Contents**

Moreover, some of our competitors are able to manufacture on 300-millimeter wafers or may choose to utilize more advanced manufacturing process technologies than we use today to offer products competitive to ours at a lower cost. If floating gate NAND vendors continue to increase their share of the Flash memory market, our market share may decrease, which would materially adversely affect us.

In addition, even if products based on NAND architecture are unsuccessful in displacing products based on NOR architecture, the average selling prices for our products may be adversely affected by a significant decline in the price for NAND architecture-based products. Such a decline may result in downward price pressure in the overall Flash memory market affecting the price we can obtain for our NOR-based products, which would adversely affect us. We believe such downward pricing pressure was a factor in the steep declines in average selling prices in the first half of 2007. If the prices for NAND products do not improve, or continue to decline, we may be materially adversely affected.

***We have a substantial amount of, and continue to incur, indebtedness which could adversely affect our financial position.***

We currently have and will continue to have for the foreseeable future, a substantial amount of indebtedness. Our indebtedness has increased over time. At the time of our IPO in December 2005, our aggregate principal amount of outstanding debt was approximately \$760.0 million. As of September 30, 2007, we had an aggregate principal amount of approximately \$1.4 billion in outstanding debt. In order to advance our business with new technologies, like other semiconductor manufacturers, we are required to make sizable capital investment in facilities and equipment. If cash flow from operations is not sufficient to meet capital requirements, we may need to incur additional indebtedness.

Our substantial indebtedness may:

require us to use a substantial portion of our cash flows from operations to make debt service payments;

make it difficult for us to satisfy our financial obligations;

limit our ability to use our cash flows, use our available financings to the fullest extent possible, or obtain additional financing for future working capital, capital expenditures, acquisitions or other general corporate purposes;

limit our flexibility to plan for, or react to, changes in our business and industry;

place us at a competitive disadvantage compared to our less leveraged competitors; and

increase our vulnerability to the impact of adverse economic and industry conditions.

***We are currently party to and intend to enter into debt arrangements in the future, each of which may subject us to restrictive covenants which could limit our ability to operate our business.***

We are party to a \$175.0 million senior secured revolving credit facility that imposes various restrictions and covenants on us that limits our ability to:

enter into any mergers, consolidations or sales of property, or sales of inventory, equipment and assets except in the ordinary course of business;

---

**Table of Contents**

make any distributions except for distributions from Spansion LLC to us in specified circumstances;

make investments, except for the purchase of inventory, equipment and intellectual property in the ordinary course of business, unless we meet minimum liquidity requirements consisting of availability under the revolving credit facility and domestic cash of at least \$200.0 million, provided, however, that investments are limited to no more than a total of \$50.0 million while the reduced minimum liquidity requirement is in place;

incur additional debt, enter into capital leases and, in limited cases, make loans to subsidiaries;

engage in transactions with affiliates unless the transactions are in the normal course of business, negotiated at arms-length and disclosed to the agent for the lenders;

incur any new liens except for equipment leases and loans; and

prepay any debt, except that debt of foreign subsidiaries may be prepaid by the applicable foreign subsidiary and we may prepay any debt as long as after such repayment we meet minimum liquidity requirements consisting of availability under the revolving credit facility plus domestic cash of at least \$250.0 million.

In addition, the indentures governing Spansion LLC's \$250.0 million principal amount of 11.25% Senior Notes due 2016 and Spansion LLC's \$625.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2013 impose substantially similar restrictions and covenants on us which could limit our ability to respond to market conditions, make capital investments or take advantage of business opportunities.

In the future, we will likely incur additional indebtedness through arrangements such as credit agreements or term loans that may also impose similar restrictions and covenants. These restrictions and covenants limit, and any future covenants and restrictions likely will limit, our ability to respond to market conditions, to make capital investments or to take advantage of business opportunities. Any debt arrangements we enter into would likely require us to make regular interest payments, which would adversely affect our results of operations.

As of September 30, 2007, we were in compliance with the financial covenants under our debt instruments. However, we cannot assure you that in the future we will be able to satisfy the covenants, financial tests and ratios of our debt instruments, which can be affected by events beyond our control. If we fail to comply with such covenants, we cannot assure you that we will be able to obtain waivers for any future failures to comply with our financial covenants, or amendments which will prevent a failure to comply in the future. A breach of any of the covenants, financial tests or ratios under our debt instruments could result in a default under the applicable agreement, which in turn could trigger cross-defaults under our other debt instruments, any of which would materially adversely affect us.

***If we cannot generate sufficient operating cash flows and obtain external financing, we may be unable to make all of our planned capital expenditures.***

Our ability to fund anticipated capital expenditures depends on generating sufficient cash flows from operations and the continued availability of external financing. We expect our total capital expenditures for fiscal 2007 to be approximately \$1.0 billion, depending upon timing of

## **Table of Contents**

capital deliveries during the fourth quarter of fiscal 2007. Our capital expenditures, together with ongoing operating expenses, will be a substantial drain on our cash flows and may decrease our cash balances. The timing and amount of our capital requirements cannot be precisely determined at this time and will depend on a number of factors, including demand for our products, product mix, changes in industry conditions and market competition.

We may assess markets for external financing opportunities, including debt and equity. Such financing may not be available when needed or, if available, may not be available on satisfactory terms. Moreover, the funds availability under our existing \$175.0 million senior secured revolving credit facility may be adversely affected by our financial condition, results of operations and incurrence or maintenance of additional debt, such as our 11.25% Senior Notes due 2016 and our 2.25% Exchangeable Senior Secured Debentures. Also, funds availability under the Spansion Japan 2007 Credit Facility are based on capital deliveries to Spansion Japan's SP1 300mm manufacturing facility, which may not be made in a timely manner. Finally, any equity financing may not be desirable because of resulting dilution to our stockholders. Our inability to obtain needed financing or to generate sufficient cash from operations may require us to abandon projects or curtail capital expenditures. If we cannot generate sufficient operating cash flows or obtain external financing, we may be delayed in achieving, or may not achieve, needed manufacturing capacity, and we could be materially adversely affected.

***If we are unable to timely and efficiently expand our manufacturing capacity to implement 300-millimeter wafer capacity at SP1, and achieve a competitive wafer cost for SP1 output, our business and financial results could be materially adversely affected.***

We intend to expand our manufacturing capacity to produce 300-millimeter wafers at our Flash memory manufacturing facility in Aizu-Wakamatsu, Japan, which we refer to as SP1. In fiscal 2006 we commenced a plan to spend approximately \$1.2 billion over three years to construct and equip SP1 for production of 65-nanometer process technology on 300-millimeter wafers by late 2007, and production of 45-nanometer process technology on 300-millimeter wafer capacity in 2008. In order for SP1 to produce wafers at a competitive cost, we must achieve suitable economies of scale which we anticipate will require additional capital expenditures at SP1 to reach our planned manufacturing capacity. Financing may not be available when needed or, if available, may not be available on satisfactory terms. If we do not achieve our desired capacity at the anticipated cost, or if we cannot obtain suitable financing, we could be materially adversely affected.

The timing for implementing 300-millimeter capacity in SP1 will also depend in part on our ability to execute our plan for equipping the facility and other factors that may be beyond our control, such as delivery schedules for the required machinery and equipment and construction schedules. If we are delayed in implementing this capability or are unable to obtain foundry services at competitive rates or to timely and efficiently ramp production on 300-millimeter wafers, we will not achieve anticipated cost savings associated with this technology and our gross margins could decline. Even if we are successful in implementing this capacity, if the demand for our products is not sufficient to support the additional capacity when it becomes available, we could be materially and adversely affected.

***The loss of a significant customer or a reduction in demand for our Flash memory products from a significant customer could have a material adverse effect on us.***

We serve our customers worldwide directly through our sales force and indirectly through our distributors, who purchase products from us and sell them to customers, either directly or through their distributors. Our customers consist of OEMs, original design manufacturers and contract manufacturers. In fiscal 2005, fiscal 2006, and during the first nine months of fiscal

## **Table of Contents**

2007, the five largest of these customers accounted for a significant portion of end sales of our products. If one of these customers stopped purchasing our Flash memory products, or if one of these customers were to materially reduce its demand for our products, we could be materially adversely affected. For example, in the fourth quarter of fiscal 2006 we were materially adversely affected by the reduced customer demand for some of our custom high density NOR-based Flash memory solutions.

Our business strategy is to continue to maintain and increase our market share, diversify our customer base in the integrated category of the Flash memory market, and enter new markets enabled by our MirrorBit technology. We cannot assure you that we will be successful in implementing this strategy, and if we are unsuccessful, we could be materially adversely affected. If we fail to successfully diversify our customer base and we lose a significant customer or suffer a reduction in demand from a significant customer, our business may be materially adversely affected.

***If we fail to successfully develop, introduce and commercialize new products and technologies or to accelerate our product development cycle, we may be materially adversely affected.***

Our success depends to a significant extent on the development, qualification, production, introduction and acceptance of new product designs and improvements that provide value to Flash memory customers. We must also be able to accomplish this process at a faster pace than we currently do. For example, we introduced products on 90-nanometer process technology in 2006 and plan to be in production on 65-nanometer process technology in late 2007 and in production on 45-nanometer process technology in 2008. Our ability to develop and qualify new products and related technologies to meet evolving industry requirements, at prices acceptable to our customers and on a timely basis are significant factors in determining our competitiveness in our target markets. If we are delayed in developing or qualifying new products or technologies, we could be materially adversely affected. For example, during the second half of fiscal 2004 and the first quarter of fiscal 2005, we experienced a delay in qualifying and introducing a new Flash memory product based on our MirrorBit technology for wireless Flash memory customers. The delay, which was due to our having to re-design the product in order to achieve higher performance specifications under all temperature conditions, contributed to lower than anticipated net sales during the second half of fiscal 2004 and the first six months of fiscal 2005 and caused us to lose market share.

***Competitors may introduce new memory or other technologies that may make our Flash memory products uncompetitive or obsolete.***

Our competitors are working on a number of new technologies, including FRAM, MRAM, polymer, charge trapping and phase-change based memory technologies. Some of our competitors have announced plans to bring to market products based on phase-change based memory technology in late 2007 and 2008. If such products are successfully developed and commercialized as a viable alternative to MirrorBit or floating gate Flash memory, these other products could pose a competitive threat to a number of Flash memory companies, including us. In addition, we and some of our competitors have licensed Flash memory intellectual property associated with NROM technology from a third party. Use of this NROM intellectual property or use of independently developed charge trapping Flash memory technology by our competitors, if successfully developed and commercialized, may allow these competitors to develop Flash memory technology that may compete with our proprietary MirrorBit technology.

---

**Table of Contents**

*If we fail to successfully develop products based on our new MirrorBit ORNAND, MirrorBit Eclipse or MirrorBit Quad architectures, or if there is a lack of market acceptance of these products, our future operating results would be materially adversely affected.*

We are positioning ourselves to address the increasing demand for data optimized Flash memory by offering higher density, lower cost and more versatile products based on our new MirrorBit ORNAND, MirrorBit Quad and MirrorBit Eclipse architectures. The success of these architectures requires that we timely and cost effectively develop, manufacture and market products based on these architectures that are competitive with floating gate NAND-based Flash memory solutions. We began commercial shipments of MirrorBit ORNAND-based products in the second quarter of fiscal 2006 and began commercial shipments of MirrorBit Quad-based products in the first quarter of 2007. However, if we fail to develop and commercialize these products and additional products based on these architectures on a timely basis, our future operating results would be materially adversely affected. Furthermore, if market acceptance of products based on our MirrorBit architectures occurs at a slower rate than we anticipate, our ability to compete will be reduced, and we would be materially adversely affected. If we do not achieve market acceptance of these architectures or subsequent MirrorBit products, our future operating results would be materially adversely affected.

*Manufacturing capacity constraints may adversely affect us.*

There may be situations in which our manufacturing capacity is inadequate to meet the demand for some of our products. We increasingly depend on foundry, subcontractor and similar arrangements with third parties to meet demand. Our arrangements with third-party suppliers do not necessarily include capacity guarantees. If a third-party manufacturer on which we rely does not have the capacity to deliver an adequate amount of product to meet actual demand, we may not be able to obtain the manufacturing capacity, either in our own facilities or through other third-party arrangements, to meet such demand. During fiscal 2006, demand for certain of our products exceeded the available supply. As a result, we were unable to meet the demand of some of our customers for these products. This adversely impacted our relationships with these customers, and comparable situations in the future could cause harm to our reputation in the marketplace, cause these customers to move future business to our competitors or cause us to make financial concessions to our customers. Any of these occurrences could have a material adverse effect on us. Also, in the third and fourth quarters of fiscal 2005 and fiscal 2006, we experienced capacity constraints for final test and assembly of some of our products. While we have worked internally and with subcontractors to increase capacity to meet anticipated demand, we cannot assure you that we will not experience similar constraints in the future. These capacity constraints limit our ability to respond to rapid and short-term surges or changes in demand for our products. If we are unable to obtain sufficient manufacturing capacity to meet anticipated demand, either in our own facilities or through foundry, subcontractor or similar arrangements with third parties, or if we are unable to obtain foundry services at competitive rates, our business may be materially adversely affected.

*Our increased reliance on third-party manufacturers entails risks that could materially adversely affect us.*

We currently obtain foundry services from other companies, including Taiwan Semiconductor Manufacturing Company Limited and Fujitsu (due to our recent sale of our JV1/JV2 manufacturing facilities). In addition, we recently entered into an agreement with Semiconductor Manufacturing International Corporation under which we may obtain foundry services in the future. We also use independent contractors to perform some of the assembly, testing and packaging of our products. Third-party manufacturers are often under no obligation to provide us with any specified minimum quantity of product. We depend on these manufacturers to allocate to us a portion of their manufacturing capacity sufficient to meet our needs, to produce products of acceptable quality and at acceptable manufacturing yields and to deliver those products to us on a timely basis at acceptable prices. We cannot assure you that these manufacturers will be able to meet our near-term or long-term manufacturing requirements.

---

**Table of Contents**

These manufacturers also make products for other companies, including certain of our competitors, and/or for themselves and could choose to prioritize capacity for themselves or other customers beyond any minimum guaranteed amounts, reduce deliveries to us or, in the absence of price guarantees, increase the prices they charge us on short notice, such that we may not be able to pass cost increases on to our customers. Because it could take several quarters or more to establish a relationship with a new manufacturing partner, we may be unable to secure an alternative supply for specific products in a short timeframe or at all at an acceptable cost to satisfy our production requirements. In addition, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. Other risks associated with our increased dependence on third-party manufacturers include: their ability to adapt to our proprietary technology, reduced control over delivery schedules, quality assurance, manufacturing yields and cost, lack of capacity in periods of excess demand, misappropriation of our intellectual property, reduced ability to manage inventory and parts and risks associated with operating in foreign countries. If we are unable to secure sufficient or reliable suppliers of wafers or obtain the necessary assembling, testing and packaging services, our ability to meet customer demand for our products may be adversely affected, which could have a material adverse effect on us.

***Industry overcapacity could require us to lower our prices and have a material adverse effect on us.***

Semiconductor companies with their own manufacturing facilities and specialist semiconductor foundries, which are subcontractors that manufacture semiconductors designed by others, have added significant capacity in recent years and are expected to continue to do so. In the past, capacity additions sometimes exceeded demand requirements leading to oversupply situations and downturns in the industry. Fluctuations in the growth rate of industry capacity relative to the growth rate in demand for Flash memory products contribute to cyclicalities in the Flash memory market, which may in the future negatively impact our average selling prices and materially adversely affect us.

***Industry overcapacity could cause us to under-utilize our manufacturing capacity and have a material adverse effect on us.***

It is difficult to predict future growth or decline in the markets we serve, making it very difficult to estimate requirements for production capacity. If our target markets do not grow as we anticipate, we may under-utilize our manufacturing capacity. This may result in write-downs or write-offs of inventories and losses on products the demand for which is lower than we anticipate. In addition, during periods of industry overcapacity, such as we have recently experienced, customers do not generally order products as far in advance of the scheduled shipment date as they do during periods when our industry is operating closer to capacity, which can exacerbate the difficulty in forecasting capacity requirements.

Many of our costs are fixed. Additionally, pursuant to some of our subcontractor and foundry arrangements with third parties we may incur and pay penalties, according to which we have agreed to pay for a certain amount of product even if we do not accept delivery of all of such amount. Accordingly, during periods in which we under-utilize our manufacturing capacity as a result of reduced demand for some of our products, our costs cannot be reduced in proportion to the reduced revenues for such periods. When this occurs, our operating results are materially adversely affected.

***Our customers' ability to change booked orders may lead to excess inventory.***

Because our manufacturing processes require long lead times, we use indicators such as booking rates and book-to-bill ratios, in conjunction with other business metrics, to schedule production in our fabrication facilities. Consequently, when customers change orders booked by us, our planned manufacturing capacity may be greater or less than actual demand, resulting in less than optimal inventory levels. When this occurs, we adjust our production levels but such adjustments may not prevent our production of excess inventory in environments when bookings and book-to-bill ratios are strong. As a result, our business may be materially adversely affected.



**Table of Contents**

***Intense competition in the Flash memory market could materially adversely affect us.***

Our principal competitors in the Flash memory market are Intel Corporation, Samsung Electronics Co., Ltd., STMicroelectronics, Silicon Storage Technology, Inc., Macronix International Co., Ltd., Toshiba Corporation, Sharp Electronics Corp., Renesas Technology Corp., Micron Technology, Inc. and Hynix Semiconductor Inc. In the future, our principal competitors may also include Numonyx, the announced joint venture between Intel and STMicroelectronics, SanDisk Corporation and IM Flash Technology, LLC, the joint venture between Intel and Micron Technology, Inc. The Flash memory market is characterized by intense competition. The basis of competition is cost, selling price, performance, quality, customer relationships and ability to provide value-added solutions. In particular, in the past, our competitors have aggressively priced their products, which resulted in decreased average selling prices for our products in the first half of fiscal 2007 and adversely impacted our results of operations. Some of our competitors, including Intel, Samsung, STMicroelectronics, Toshiba, Sharp and Renesas, are more diversified than we are and may be able to sustain lower operating margins in their Flash memory business based on the profitability of their other, non-Flash memory businesses. In addition, recent capital investments by competitors have resulted in substantial industry manufacturing capacity, which may further contribute to a competitive pricing environment. Moreover, some of our competitors are able to manufacture on 300-millimeter wafers or may choose to utilize more advanced manufacturing process technologies than we use today to offer products competitive to ours at a lower cost.

We expect competition in the market for Flash memory devices to intensify as existing manufacturers introduce new products, new manufacturers enter the market, industry-wide production capacity increases and competitors aggressively price their Flash memory products to increase market share. Competition also may increase if NOR memory vendors merge, if NAND memory vendors acquire NOR businesses or other NAND businesses, or if our competitors otherwise consolidate their operations. For example, Intel Corporation and STMicroelectronics announced their intention to form a joint venture which will combine their respective Flash memory businesses. If they are successful in establishing the joint venture, we expect it will immediately become a significant direct competitor. Furthermore, we face increasing competition from NAND Flash memory vendors in some portions of the integrated Flash memory market.

We also expect to face competition as we address new applications with the introduction of our MirrorBit ORNAND-, MirrorBit Quad- and MirrorBit Eclipse- based architectures. These products are intended to allow us to compete in the data storage portion of the integrated category and select portions of the removable category of the Flash memory market that might otherwise be served by NAND-based Flash memory products or other non-volatile storage technologies such as ROM or optical discs. As a result, we may compete with a number of established NAND-based Flash memory vendors and other incumbent suppliers of alternative technology in

## **Table of Contents**

Marketing and selling these products. Moreover, products based on our MirrorBit ORNAND, MirrorBit Quad and MirrorBit Eclipse architectures may not have the price, performance, quality and other features necessary to compete successfully for these applications.

To compete successfully, we must decrease our manufacturing costs and develop, introduce and sell products at competitive prices that meet the increasing demand for greater Flash memory content in mobile phones, consumer electronics, automotive and other applications. If we are unable to compete effectively, we could be materially adversely affected.

***We cannot be certain that our substantial investments in research and development will lead to timely improvements in technology or that we will have sufficient resources to invest in the level of research and development that is required to remain competitive.***

We make substantial investments in research and development for design, process technologies and production in an effort to design and manufacture advanced Flash memory products. For example, in fiscal 2006 and the first nine months of fiscal 2007, our research and development expenses were approximately \$342.0 million and \$324.0 million, respectively, or approximately 13 and 18 percent, respectively, of our net sales.

Currently, we are developing new non-volatile memory process technologies, including 65-nanometer and 45-nanometer process technologies. Our Submicron Development Center facility is developing manufacturing process technologies on 300-millimeter wafers. We cannot assure you that we will have sufficient resources to maintain the level of investment in research and development that is required for us to remain competitive, which could materially adversely affect us. Further, we cannot assure you that our investments in research and development will result in increased sales or competitive advantage, which could adversely affect our operating results.

***Unless we maintain manufacturing efficiency, we may not become profitable and our future profitability could be materially adversely affected.***

The Flash memory industry is characterized by rapid technological changes. For example, new manufacturing process technologies using smaller feature sizes and offering better performance characteristics are generally introduced every one to two years. The introduction of new manufacturing process technologies allows us to increase the functionality of our products while at the same time optimizing performance parameters, decreasing power consumption and/or increasing storage capacity. In addition, the reduction of feature sizes enables us to produce smaller chips offering the same functionality and thereby considerably reduces the costs per bit. In order to remain competitive, it is essential that we secure the capabilities to develop and qualify new manufacturing process technologies. For example, our leading Flash memory products must be manufactured at 65-nanometer and more advanced process technologies and on 300-millimeter wafers. If we are delayed in transitioning to these technologies and other future technologies, we could be materially adversely affected.

Manufacturing our products involves highly complex processes that require advanced equipment. Our manufacturing efficiency is an important factor in our profitability, and we cannot be sure that we will be able to maintain or increase our manufacturing efficiency to the same extent as our competitors. For example, we continuously modify our manufacturing processes in an effort to improve yields and product performance and decrease costs. We are continuing to transition products to 90-nanometer process technology and developing the 65-nanometer process technology for the manufacture of some of our products. During periods when we are implementing new process technologies, manufacturing facilities may not be fully productive. We may fail to achieve acceptable yields or may experience product delivery delays as a result of, among other things, capacity constraints, delays in the development of new process

---

**Table of Contents**

technologies, changes in our process technologies, upgrades or expansion of existing facilities, impurities or other difficulties in the manufacturing process. Any of these occurrences could adversely impact our relationships with customers, cause harm to our reputation in the marketplace, cause customers to move future business to our competitors or cause us to make financial concessions to our customers. For example, in the third quarter of fiscal 2006, we had lower than expected yields on 12,000 raw wafers and, as a result, we were unable to meet the demand of some of our customers, including in Japan, and our revenue and gross margins were adversely affected.

Improving our manufacturing efficiency in future periods is dependent on our ability to:

develop advanced process technologies and advanced products that utilize those technologies;

successfully transition to 65-nanometer and more advanced process technologies;

continue to reduce test times;

ramp product and process technology improvements rapidly and effectively to commercial volumes across our facilities;

achieve acceptable levels of manufacturing wafer output and yields, which may decrease as we implement more advanced technologies; and

maintain our quality controls and rely upon the quality and process controls of our suppliers.

***If we cannot adequately protect our technology or other intellectual property in the United States and abroad, through patents, copyrights, trade secrets, trademarks and other measures, we may lose a competitive advantage and incur significant expenses.***

We rely on a combination of protections provided by contracts, including confidentiality and non-disclosure agreements, copyrights, patents, trademarks and common law rights, such as trade secrets, to protect our intellectual property. However, we cannot assure you that we will be able to adequately protect our technology or other intellectual property from third-party infringement or from misappropriation in the United States and abroad. Any patent owned or licensed by us or issued to us could be challenged, invalidated or circumvented or rights granted under these patents or licenses may not provide a competitive advantage to us. Furthermore, patent applications that we file may not result in issuance of a patent or, if a patent is issued, the patent may not be issued in a form that is advantageous to us. Despite our efforts to protect our intellectual property rights, others may independently develop similar products, duplicate our products or design around our patents and other intellectual property rights. In addition, it is difficult to monitor compliance with, and enforce, our intellectual property on a worldwide basis in a cost-effective manner. Foreign laws may provide less intellectual property protection than afforded in the United States. If we cannot adequately protect our technology or other intellectual property rights in the United States and abroad, we may be materially adversely affected.

***We are party to intellectual property litigation and may become party to other intellectual property claims or litigation that could cause us to incur substantial costs or pay substantial damages or prohibit us from selling our products.***

We provide indemnities relating to non-infringement of patents and other intellectual property indemnities to certain of our customers in connection with the delivery, design,

---

**Table of Contents**

manufacture and sale of our products. From time to time, we may be notified, or third parties may bring actions against us based on allegations, that we are infringing the intellectual property rights of others. If any such claims are asserted against us, we may seek to obtain a license under the third party's intellectual property rights. We cannot assure you that we will be able to obtain all of the necessary licenses on satisfactory terms, if at all. In the event that we cannot obtain a license, these parties may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted, which could result in our having to stop the sale of some of our products, increase the costs of selling some of our products, or cause damage to our reputation. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture and sale of some or all of our products, would have a material adverse effect on us. We could decide, in the alternative, to redesign our products or to resort to litigation to challenge or defend such claims, either of which could be expensive and time-consuming and may have a material adverse effect on us.

For example, Tessera, Inc. filed lawsuits against us alleging that we have infringed certain of Tessera's patents. Tessera has sought to enjoin such alleged infringements, to recover an unspecified amount of damages, and to bar our importation and sale of allegedly infringing products. In addition, Fujitsu has informed us that Texas Instruments has asserted that a number of our products infringe some of Texas Instruments' patents. Fujitsu has also informed us that it expects us to defend and indemnify Fujitsu against Texas Instruments' claims. Fujitsu has provided us with formal notice that they believe we have a duty to defend or indemnify Fujitsu under the terms of our distribution agreement. Since then, we and Fujitsu have been discussing the issues raised by this notice, and if Fujitsu were to terminate our distribution agreement, we could be materially adversely affected. Defending these alleged infringement claims and similar claims could be extremely expensive and time-consuming and an award of damages or an injunction could have a material adverse effect on us. We cannot assure you that litigation related to the intellectual property rights of ours or others can be avoided or will be successfully concluded.

***Our inability to design and implement new enterprise-wide information systems in a timely and cost-effective manner could materially adversely affect us.***

Although we have completed our physical separation from AMD's information systems, we are continuing to design and implement our own enterprise-wide information systems. These systems have been designed to automate more fully our business processes and affect most of our functional areas including sales, finance, procurement, inventory control, collections, order processing and manufacturing. In connection with the implementation of these information systems, we may experience functional and performance problems, including problems relating to the information systems' response time and data integrity. In addition, resolution of any such problems could entail significant additional costs. We cannot assure you that we will be able to implement these information systems successfully or on a timely basis and in a cost-effective manner or that these information systems will not fail or prove to be unsuitable for our needs. Our inability to implement or resolve problems with these information systems in a timely and cost-effective manner could materially adversely affect us.

***If essential equipment or adequate supplies of satisfactory materials are not available to manufacture our products, we could be materially adversely affected.***

Our manufacturing operations depend upon obtaining deliveries of equipment and adequate supplies of materials on a timely basis. We purchase equipment and materials from a number of suppliers. From time to time, suppliers may extend lead times, limit supply to us or increase prices due to capacity constraints or other factors. Because the equipment that we purchase is

## **Table of Contents**

complex, it is difficult for us to substitute one supplier for another or one piece of equipment for another. Some raw materials we use in the manufacture of our products are available from a limited number of suppliers. Our manufacturing operations also depend upon the quality and usability of the materials we use in our products, including raw materials and wafers we receive from our suppliers. For example, in the third quarter of fiscal 2006, we had lower than expected yields on 12,000 raw wafers received from one of our suppliers and our revenue and gross margins were adversely affected. If the materials we receive from our suppliers do not meet our manufacturing requirements or product specifications, we may be materially adversely affected.

We also rely on purchasing commercial memory die such as DRAMs from third-party suppliers to incorporate these die into multi-chip package, or MCP, products. The availability of these third-party purchased commercial die is subject to market availability, and the process technology roadmaps and manufacturing capacities of our vendors. For example, our production was constrained in the first half of fiscal 2004 because of difficulties in procuring adequate supply of pseudo static RAM, or pSRAM. In addition, some of our major suppliers, including Samsung, are also our competitors. Interruption of supply from a competitor that is a supplier or otherwise or increased demand in the industry could cause shortages and price increases in various essential materials. If we are unable to procure these materials, or if the materials we receive from our suppliers do not meet our production requirements or product specifications, we may have to reduce our manufacturing operations or our manufacturing yields may be adversely affected. Such a reduction and yield issues have in the past and could in the future have a material adverse effect on us.

### ***Our inability to continue to attract, retain and motivate qualified personnel could impact our business.***

Our future success depends upon the continued service of numerous qualified engineering, manufacturing, marketing, sales and executive personnel. We cannot assure you that our equity incentive plan or our employee benefit plans will be effective in motivating or retaining our employees or attracting new employees. Competition for qualified employees among companies that rely heavily on engineering and technology is intense, and the loss of key employees or executive personnel or an inability to attract, retain and motivate additional highly skilled employees could materially adversely affect us.

### ***Costs related to defective products could have a material adverse effect on us.***

One or more of our products may be found to be defective after the product has been shipped to customers in volume. The cost of product replacements or product returns may be substantial, and our reputation with our customers would be damaged. In addition, we could incur substantial costs to implement modifications to fix defects. Any of these problems could materially adversely affect us.

### ***Uncertainties involving the ordering of our products could materially adversely affect us.***

Flash memory suppliers compete in part on the basis of their ability to deliver products to end customers on short lead times and it is common for prevailing lead times in the market to be shorter than the minimum manufacturing cycle time. To deliver products with competitive lead times, we must maintain a buffer stock of product to fulfill customer orders. Because our buffer stock must be produced before customer orders are received, our production levels are based on forecasts of customer demand. Generally, we sell our products pursuant to individual purchase orders from our direct customers, distributors and our distributors' customers. Generally, these customers and distributors may cancel their orders for standard products thirty days prior to shipment without incurring a significant penalty.

## **Table of Contents**

Customer demand for our products may be difficult to predict because such customers may change their inventory practices on short notice for any reason or they may cancel or defer product orders. Inaccurate forecasts of customer demand or cancellation or deferral of product orders could result in excess or obsolete inventory, which could result in write-downs of inventory. Because market conditions are uncertain, we could be materially adversely affected if we are unable to accurately predict demand for our products.

### ***We may not be successful in establishing a brand identity.***

We have used the brand name Spansion since June 2003. Prior to that time, all of our Flash memory products were sold under either AMD's or Fujitsu's brand. AMD's and Fujitsu's brand names are well known by Flash memory customers, suppliers and potential employees. We expend time, effort and resources to continue to establish our brand name in the marketplace. We cannot assure you that this effort will ultimately be successful. If we are unsuccessful in continuing to establish our brand identity, we may be materially adversely affected.

### ***Unfavorable currency exchange rate fluctuations could adversely affect us.***

As a result of our foreign operations, we have sales, expenses, assets and liabilities that are denominated in Japanese yen and other foreign currencies. For example,

some of our manufacturing costs are denominated in Japanese yen, Chinese renminbi, and other foreign currencies such as the Thai baht and Malaysian ringgit;

sales of our products to Fujitsu are denominated in both US dollars and Japanese yen; and

some fixed asset purchases are denominated in Japanese yen and European Union euros.

Consequently, movements in exchange rates could cause our net sales and expenses to fluctuate, affecting our profitability and cash flows. We use foreign currency forward contracts to reduce our exposure to foreign currency exchange rate fluctuations. The objective of these contracts is to reduce the impact of foreign currency exchange rate movements on our operating results and on the cost of capital asset acquisitions. We do not use these contracts for speculative or trading purposes. We cannot assure you that these activities will be successful in reducing our foreign currency exchange rate exposure. Failure to do so could have a material adverse effect on us.

### ***Worldwide economic and political conditions may adversely affect demand for our products.***

Worldwide economic conditions may adversely affect demand for our products. For example, China's economy has been growing at a fast pace over the past several years, and the Chinese government introduced various measures to slow down the pace of economic growth. We believe some of these measures negatively impacted demand for our Flash memory products in the second half of fiscal 2004. A decline in economic conditions in China could lead to declining worldwide economic conditions. If economic conditions decline, whether in China, another country or worldwide, we could be materially adversely affected.

Our consolidated financial results could also be significantly and adversely affected by geopolitical concerns and world events, such as wars and terrorist attacks. Our revenues and financial results have been and could be negatively affected to the extent geopolitical concerns continue and similar events occur or are anticipated to occur. In particular, consequences of military action in the Middle East have in the past, and may in the future, adversely affect demand for our products and our relationship with various third parties with which we collaborate. In addition, terrorist attacks may negatively affect our operations, directly or

**Table of Contents**

indirectly, and such attacks or related armed conflicts may directly impact our physical facilities or those of our suppliers or customers. Furthermore, these attacks may make travel and the transportation of our products more difficult and more expensive, which could materially adversely affect us.

The United States has been and may continue to be involved in armed conflicts that could have a further impact on our sales and our supply chain. Political and economic instability in some regions of the world may also result and could negatively impact our business. The consequences of armed conflicts are unpredictable, and we may not be able to foresee events that could have a material adverse effect on us. More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. economy and worldwide financial markets. Any of these occurrences could have a material adverse effect on us.

***Our operations in foreign countries are subject to political and economic risks, which could have a material adverse effect on us.***

The majority of our wafer fabrication capacity is located in Japan and nearly all final test and assembly of our products is performed at our facilities in China, Malaysia and Thailand and by third parties in Taiwan and Japan. In addition, we have international sales operations and, as part of our business strategy, we are continuing to seek to expand our product sales in high growth markets. The political and economic risks associated with our sales to, and operations in, foreign countries include:

expropriation;

changes in political or economic conditions;

changes in tax laws, trade protection measures and import or export licensing requirements;

difficulties in protecting our intellectual property;

difficulties in achieving headcount reductions;

changes in foreign currency exchange rates;

restrictions on transfers of funds and other assets of our subsidiaries between jurisdictions;

changes in freight and interest rates;

disruption in air transportation between the United States and our overseas facilities; and

loss or modification of exemptions for taxes and tariffs.

Any conflict or uncertainty in the countries in which we operate, including public health or safety concerns, natural disasters or general economic factors, could have a material adverse effect on our business. Any of the above risks, should they occur, could have a material adverse effect on us.





## **Table of Contents**

*We are subject to a variety of environmental laws that could result in liabilities.*

Our properties and many aspects of our business operations are subject to various domestic and international environmental laws and regulations, including those relating to materials used in our products and manufacturing processes; chemical use and handling; waste minimization; discharge of pollutants into the environment; the treatment, transport, storage and disposal of solid and hazardous wastes; and remediation of contamination. Certain of these laws and regulations require us to obtain permits for our operations, including permits related to the discharge of air pollutants and wastewater. From time to time, our facilities are subject to investigation by governmental regulators. Environmental compliance obligations and liability risks are inherent in many of our manufacturing and other activities. Any failure to comply with applicable environmental laws, regulations or permits may subject us to a range of consequences, including fines, suspension of production, alteration of manufacturing processes, sales limitations, and criminal and civil liabilities or other sanctions. We could also be held liable for any and all consequences arising out of exposure to hazardous materials used, stored, released, disposed of by us or located at or under our facilities, or for other environmental or natural resource damage.

Certain environmental laws, including the U.S. Comprehensive, Environmental Response, Compensation and Liability Act of 1980, or the Superfund Act, impose joint and several liability on current and previous owners or operators of real property for the cost of removal or remediation of hazardous substances and costs related to damages to natural resources. Liability can attach even if the owner or operator did not know of, or was not responsible for, the release of such hazardous substances. These environmental laws also can result in liability for persons, like us, who arrange for hazardous substances to be sent to disposal or treatment facilities, in the event such facilities are found to be contaminated. Such persons can be responsible for cleanup costs at a disposal or treatment facility, even if they never owned or operated the contaminated facility. One property where we currently conduct research and development operations is listed on the U.S. Environmental Protection Agency's Superfund National Priorities List. However, other parties currently are responsible for all investigation, cleanup and remediation activities. Although we have not been named a responsible party at this site, if we were so named, costs associated with the cleanup of the site could have material adverse effect upon us.

We have not been named a responsible party at any Superfund or other contaminated site. If we were ever so named, costs associated with the cleanup of the site could be material. Additionally, contamination that has not yet been identified could exist at one or more of our facilities, and identification of such contamination could have a material adverse effect on us.

Our business is subject to complex and dynamic environmental regulatory schemes. While we have budgeted for reasonably foreseeable environmental expenditures, we cannot assure you that environmental laws will not change or become more stringent in the future. Future environmental regulations could require us to procure expensive pollution abatement or remediation equipment; to modify product designs; or to incur other expenses associated with compliance with such regulations. For example, the European Union and China recently began imposing stricter requirements regarding reduced lead content in semiconductor packaging. Therefore, we cannot assure you that our costs of complying with current and future environmental and health and safety laws, or liabilities arising from past or future releases of, or exposure to, hazardous substances, will not have a material adverse effect on our business.

---

**Table of Contents**

***Our worldwide operations and the operations of our suppliers could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses.***

Our worldwide operations could be subject to natural disasters and other business disruptions, such as a world health crisis, fire, earthquake, tsunami, volcano eruption, flood, hurricane, power loss, power shortage, telecommunications failure or similar events, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters are located near major earthquake fault lines in California, and one of our two wafer fabrication facilities, as well as our new 300-mm wafer fabrication facility, SP1, are located near major earthquake fault lines in Japan. In addition, our assembly and test facilities located in China, Malaysia and Thailand may be affected by tsunamis. In the event of a major earthquake or tsunami, we could experience loss of life of our employees, destruction of facilities or other business interruptions. If such business disruptions result in cancellations of customer orders or contribute to a general decrease in economic activity or demand for our products, or directly impact our marketing, manufacturing, financial, and logistics functions, our results of operations and financial condition could be materially adversely affected.

Furthermore, the operations of our suppliers could be subject to natural disasters and other business disruptions, which could cause shortages and price increases in various essential materials, such as liquid hydrogen, which are required to manufacture our products or commercial memory die such as DRAMs for incorporation into our MCP products. If we are unable to procure an adequate supply of materials that are required for us to manufacture our products, or if the operations of our other suppliers of such materials are affected by an event that causes a significant business disruption, then we may have to reduce our manufacturing operations. Such a reduction could in the future have a material adverse effect on us.

***We may be delayed or prevented from taking actions that require the consent of AMD and Fujitsu, whose interests may differ from or conflict with our interests or those of our other stockholders, which could decrease the value of your shares.***

Our bylaws provide that for so long as AMD or Fujitsu maintains an aggregate ownership interest in us of at least 10 percent, we will not be able to amend our certificate of incorporation or bylaws or effect any resolution to wind up Spansion Inc. or any other subsidiary without their prior consent.

We cannot assure you that the interests of AMD and Fujitsu will be aligned with our interests or those of our other stockholders with respect to such decisions. As a result, we may be unable to take steps that we believe are desirable and in the best interests of our stockholders. In addition, these consent rights could make an acquisition of us more difficult, even if the acquisition may be considered beneficial by some stockholders.

***The interests of AMD and Fujitsu, and our directors nominated by Fujitsu, may differ from or conflict with our interests or those of our other stockholders.***

When exercising their rights as our stockholders, either alone or in concert, AMD and Fujitsu may take into account not only our interests but also their interests and the interests of their other affiliates. Our interests and the interests of AMD and Fujitsu may at times conflict since the growth of our business depends, in part, on successful competition with other semiconductor companies. These conflicts may result in lost corporate opportunities for us, including opportunities to enter into lines of business that may overlap with those pursued by AMD and Fujitsu. We may not be able to resolve any potential conflicts, and, even if we do so, the resolution may be less favorable to us than if we were dealing with unaffiliated parties.

Various other conflicts of interest between AMD, Fujitsu and us may arise in the future in a number of areas relating to our business and relationships, including potential acquisitions of businesses or properties, intellectual property matters, transfers by AMD or Fujitsu of all or any portion of its ownership interest in us or its other assets, which could be to one of our competitors, indemnity arrangements, service arrangements and business opportunities that may be attractive to AMD, Fujitsu and us.

## **Table of Contents**

AMD and Fujitsu are two of our largest stockholders. Fujitsu has the right to elect one member to our board of directors. Each stockholder's ability to elect directors is subject to reduction based on the amount of our common stock that they own and this right terminates when their ownership in us falls below 10 percent.

Individuals who are our directors and also officers of Fujitsu have a duty of care and loyalty to us when acting in their capacities as our directors and a duty of care and loyalty to Fujitsu when acting as their officers or directors. However, our certificate of incorporation provides that in the event a director or officer of our company who is also a director or officer of Fujitsu acquires knowledge of a potential business opportunity that may be deemed a corporate opportunity of our company and Fujitsu, such opportunity will belong to Fujitsu, as applicable, unless it has been expressly offered to such director or officer in writing solely in his or her capacity as a director or officer of our company. Ownership of AMD common stock by any of our officers could create, or appear to create, potential conflicts of interest when those directors and officers are faced with decisions that could have different implications for AMD than they do for us.

### ***Our stock price may decline as a result of sales of common stock by us, AMD or Fujitsu.***

Our reorganization in 2003 was the commencement of AMD's and Fujitsu's respective divestures of their Flash memory businesses. Since that time, our activities as an independent company, including our initial public offering in December 2005 and our secondary stock offering in November 2006, have been vehicles by which AMD and Fujitsu further reduced their holdings in us. AMD recently sold large numbers of our shares in the public market under Rule 144, and we expect them to continue their divesture. Sales of substantial amounts of our common stock, or the possibility of such sales, could adversely affect the market price of our common stock and impede our ability to raise capital through the issuance of additional equity securities. We cannot predict with any certainty the effects of AMD's sales, however, any further sale by AMD, or a sale by Fujitsu or us of our common stock in the public market, or the perception that sales could occur, could adversely affect prevailing market prices for our common stock. In addition, we could issue and sell additional shares of our common stock. Any sale by us of our common stock would have a dilutive effect on the outstanding shares, and could adversely affect the prevailing market prices for our common stock.

### ***Third parties may seek to hold us responsible for liabilities of AMD and Fujitsu that we did not assume in our agreements.***

Under our agreements with AMD and Fujitsu, we agreed to assume liabilities related to our business after June 30, 2003, and liabilities related to our business prior to June 30, 2003 if such liabilities were reflected as accruals or reserves on the AMD and Fujitsu contributed balance sheets. Our assumed liabilities include claims made with respect to Flash memory products sold after June 30, 2003, even if such products were manufactured prior to June 30, 2003, and warranty claims with respect to products sold prior to June 30, 2003 to the extent such warranty claims were reflected as accruals or reserves on the AMD and Fujitsu contributed balance sheets. The allocation of assets and liabilities between AMD, Fujitsu and us may not reflect the allocation that would have been reached between unaffiliated parties and may be less favorable to us as a result. Third parties may seek to hold us responsible for AMD's and Fujitsu's retained liabilities. If our losses for AMD's and Fujitsu's retained liabilities were significant and we were ultimately held liable for them, we cannot assure you that we would be able to recover the full amount of our losses.

**Table of Contents**

***We rely on Fujitsu to be our sole distributor in Japan.***

We currently rely on Fujitsu to act as the sole distributor of our products to customers in Japan, which was one of our most important geographic markets in fiscal 2006 and in the first nine months of fiscal 2007. Under our distribution agreement with Fujitsu, Fujitsu has agreed to use its best efforts to promote the sale of our products in Japan and to other customers served by Fujitsu. In the event that we reasonably determine that Fujitsu's sales performance in Japan and to those customers served by Fujitsu is not satisfactory based on specified criteria, then we have the right to require Fujitsu to propose and implement an agreed-upon corrective action plan. If we reasonably believe that the corrective action plan is inadequate, we can take steps to remedy deficiencies ourselves through means that include appointing another distributor as a supplementary distributor to sell products in Japan and to customers served by Fujitsu. Pursuing these actions would be costly and disruptive to the sales of our products in Japan. If Fujitsu's sales performance in Japan is unsatisfactory or if we are unable to successfully maintain our distribution agreement and relationship with Fujitsu, as a result of its seeking indemnity from us in respect of certain infringement claims made by Texas Instruments or otherwise, and we can not timely find a suitable supplementary distributor, we could be materially adversely affected.

If Fujitsu unexpectedly or abruptly terminates the distribution agreement or otherwise ceases its support of our customers in Japan, we would be required to immediately establish a relationship with another distributor or establish our own local sales organization and support functions. Although we are currently establishing a sales organization and infrastructure in Japan, we cannot be certain that we will be successful in selling our products to customers currently served by Fujitsu or new customers. If customers currently served by Fujitsu, or potential new customers, refuse to purchase our products directly from us, our sales in Japan may decline, and we could be materially adversely affected.

***AMD and Fujitsu may continue to use all of our intellectual property and the intellectual property they have transferred to us.***

In connection with our reorganization as Spansion LLC in June 2003, AMD and Fujitsu transferred approximately 400 patents and patent applications to us. In addition, AMD and Fujitsu contributed additional patents to us at the time of our initial public offering. However, both AMD and Fujitsu have retained the rights to use any patents contributed to us for an unlimited period of time. In addition, under their respective patent cross-license agreements with us, AMD and Fujitsu have also obtained licenses to our present and future patents with effective filing dates prior to the later of June 30, 2013, or such date on which they have transferred all of their shares in us, although the scope of patents under license can be impacted by a change in control of the parties or their semiconductor groups. These licenses continue until the last to expire of the patents under license expires and provide AMD and Fujitsu with licenses to all of our present and future patents in existence through such cross-license termination date. Furthermore, we entered into an Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement with AMD and Fujitsu in connection with our reorganization as Spansion Inc. in December 2005. Pursuant to that agreement, subject to our confidentiality obligations to third parties, and only for so long as AMD's and Fujitsu's ownership interests in us remain above specific minimum levels, we are obligated to identify any of our technology to each of AMD and Fujitsu, and to provide copies of and training with respect to that technology to them. In addition, pursuant to this agreement we have granted a non-exclusive, perpetual, irrevocable fully paid and royalty-free license of our rights, other than patent and trademark rights, in that technology to each of AMD and Fujitsu.

---

**Table of Contents**

Under our non-competition agreement, both AMD and Fujitsu have agreed that they will not directly or indirectly engage in a business, and have agreed to divest any acquired business, that manufactures or supplies standalone semiconductor devices (including single chip, multiple chip or system devices) containing certain Flash memory, which is the business in which we primarily compete. With respect to each of AMD and Fujitsu, this non-competition restriction will last until the earlier of (i) two years from the date such stockholder's ownership in us falls to or below five percent, or (ii) the dissolution of our company. After that time, should they ever decide to re-enter the Flash memory business, AMD or Fujitsu could use our present and future patents and technologies licensed by us to AMD and Fujitsu under the cross licenses and our Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement to compete against us. If either AMD or Fujitsu were to compete with us, we could be materially adversely affected.

***Our stock price may be volatile, and stockholders may lose all or part of their investment.***

The market price of shares of our common stock has been volatile and may in the future be subject to wide fluctuations in response to many risk factors listed in this section, and others beyond our control, including:

actual or anticipated changes in our operating results;

changes in financial estimates by securities analysts;

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

announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives; and

stock price and volume fluctuations attributable to inconsistent trading volume levels or other factors.

Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of shares of our common stock. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could materially adversely affect us.

***If securities or industry analysts publish negative reports about our business, the price and trading volume of our securities could decline.***

The trading market for our securities depends, in part, on the research reports and ratings that securities or industry analysts or ratings agencies publish about us, our business and the Flash memory market in general. We do not have any control over these analysts or agencies. If one or more of the analysts or agencies who cover us downgrades us or our securities, the price of our securities may decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause the price of our securities or trading volume to decline.

---

**Table of Contents**

***We currently do not intend to pay dividends on our common stock and, consequently, our stockholders' only opportunity to achieve a return on their investment is through appreciation in the price of our common stock.***

We currently do not plan to pay dividends on shares of our common stock in the foreseeable future and are currently prohibited from doing so in specific circumstances under agreements governing our borrowing arrangements. The terms of our senior secured revolving credit facility limit our ability to pay cash dividends on any shares of our common stock. Furthermore, if we are in default under this credit facility, our ability to pay cash dividends will be limited in the absence of a waiver of that default or an amendment to that facility. Similar prohibitions are applicable under the indenture governing the outstanding notes issued by Spansion LLC. In addition, because we are a holding company, our ability to pay cash dividends on shares of our common stock may be limited by restrictions on our ability to obtain sufficient funds through dividends from our subsidiaries, including the restrictions under the indenture governing the notes. Our common stock will rank junior as to payment of dividends to any series of preferred stock that we may issue in the future. Generally, unless full dividends including any cumulative dividends still owing on all outstanding shares of any preferred stock have been paid, no dividends will be declared or paid on our common stock. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates.

***Any future issuance of our preferred stock could adversely affect holders of our common stock.***

Our board of directors is authorized to issue shares of preferred stock without any action on the part of our stockholders. Our board of directors also has the power, without stockholder approval, to set the terms of any such series of shares of preferred stock that may be issued, including voting rights, dividend rights and preferences over our common stock with respect to dividends or if we liquidate, dissolve or wind up our business and other terms. If we issue preferred stock in the future that has preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up of our affairs, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.

***The use of our net operating loss carryforwards may be limited.***

If we conduct an offering of our common stock, we may experience an ownership change as defined in the Internal Revenue Code such that our ability to utilize our federal net operating loss carryforwards of approximately \$262.0 million as of December 31, 2006 may be limited under certain provisions of the Internal Revenue Code. As a result, we may incur greater tax liabilities than we would in the absence of such a limitation and any increased liabilities could materially adversely affect us.

***Provisions in our corporate governance documents as well as Delaware law may delay or prevent an acquisition of us that stockholders may consider favorable, which could decrease the value of your shares.***

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These provisions include restrictions on the ability of our stockholders to remove directors, a classified board of directors and limitations on action by our stockholders by written consent. In addition, our board of directors has the right to issue preferred stock without stockholder approval, which could be used to make an acquisition of us more difficult. Although we believe these provisions protect our stockholders from coercive or otherwise unfair takeover tactics and thereby provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some stockholders.

---

**Table of Contents**

**ITEM 6. EXHIBITS**

- 2.1 Agreement and Plan of Merger and Reorganization, dated as of October 7, 2007, by and among Spansion Inc., Atlantic Star Merger Sub Ltd. and Saifun Semiconductors Ltd., filed as Exhibit 2.1 to Spansion's Current Report on Form 8-K dated October 9, 2007, is hereby incorporated by reference.
- 3.1 Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1 to Spansion's Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference.
- 3.2 Amended and Restated Bylaws of Spansion Inc., filed as Exhibit 3.2 to Spansion's Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference.
- 4.1 Indenture, dated as of December 21, 2005, governing the 11.25% Senior Notes due 2016, filed as Exhibit 4.1 to Spansion's Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference.
- 4.2 Specimen of 11.25% Senior Notes due 2016, filed as Exhibit 4.2 to Spansion's Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference.
- 4.3 Indenture, dated as of June 12, 2006, governing the 2.25% Exchangeable Senior Subordinated Debentures due 2016, filed as Exhibit 4.1 to Spansion's Current Report on Form 8-K dated June 12 2006, is hereby incorporated by reference.
- 4.4 Specimen of 2.25% Exchangeable Senior Subordinated Debenture due 2016, filed as Exhibit 4.1 to Spansion's Current Report on Form 8-K dated June 12 2006, is hereby incorporated by reference.
- 4.5 Indenture, dated as of May 18, 2007, governing the Senior Secured Floating Rate Notes due 2013, filed as Exhibit 4.1 to Spansion's Current Report on Form 8-K dated May 18, 2007, is hereby incorporated by reference.
- 4.6 Specimen of Senior Secured Floating Rate Notes due 2013, filed as Exhibit 4.1 to Spansion's Current Report on Form 8-K dated May 18, 2007, is hereby incorporated by reference.
- 10.30 Form of Amended and Restated Spansion Inc. Change of Control Severance Agreement.
- 10.74 Form of Voting Undertaking between Spansion and certain shareholders of Saifun Semiconductors Ltd., filed as Exhibit 10.1 to Spansion's Current Report on Form 8-K dated October 9, 2007, is hereby incorporated by reference.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 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.
- 32.2\* Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

\* Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as otherwise specifically stated in such filing.

**Table of Contents**

**SIGNATURE**

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.

SPANSION INC.

Date: November 7, 2007

By: /s/ Dario Sacomani  
Dario Sacomani  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

65