

Spansion Inc.  
Form 10-Q  
December 31, 2009  
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**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 27, 2009

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.**

(DEBTOR-IN-POSSESSION as of March 1, 2009)

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-3898239**  
(I.R.S. Employer  
Identification No.)

**915 DeGuigne Drive**

**Sunnyvale, California**  
(Address of principal executive offices)

**94088**  
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. 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 December 27, 2009:

Class	Number of Shares
Class A Common Stock, \$0.001 par value	162,291,633

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 27, 2009</b>	<b>September 28, 2008 <sup>(1)</sup></b>	<b>September 27, 2009</b>	<b>September 28, 2008 <sup>(1)</sup></b>
Net sales	\$ 262,073	\$ 474,170	\$ 814,671	\$ 1,300,621
Net sales to related parties	65,505	156,690	288,836	513,231
<b>Total net sales</b>	<b>327,578</b>	<b>630,860</b>	<b>1,103,507</b>	<b>1,813,852</b>
Cost of sales (Note 9)	234,952	544,273	898,253	1,523,654
Research and development (Note 9)	28,281	106,845	110,916	335,469
Sales, general and administrative (Note 9)	36,820	64,094	174,637	197,122
In-process research and development				10,800
Restructuring charges	7,492	1,377	45,646	11,299
<b>Operating income (loss) before reorganization items</b>	<b>20,033</b>	<b>(85,729)</b>	<b>(125,945)</b>	<b>(264,492)</b>
Other income (expense):				
Other than temporary impairment on marketable securities		(14,518)		(14,518)
Interest and other income (expense), net	532	1,432	2,928	7,347
Interest expense <sup>(2)</sup>	(9,199)	(26,949)	(42,877)	(79,249)
Gain on deconsolidation of subsidiary			30,100	
<b>Gain (loss) before reorganization items and income taxes</b>	<b>11,366</b>	<b>(125,764)</b>	<b>(135,794)</b>	<b>(350,912)</b>
Reorganization items	(9,348)		(381,647)	
<b>Income (loss) before income taxes</b>	<b>2,018</b>	<b>(125,764)</b>	<b>(517,441)</b>	<b>(350,912)</b>
Provision for income taxes	518	9,583	947	7,195
<b>Net income (loss)</b>	<b>\$ 1,500</b>	<b>\$ (135,347)</b>	<b>\$ (518,388)</b>	<b>\$ (358,107)</b>
Net income (loss) per share				
Basic	\$ 0.01	\$ (0.84)	\$ (3.21)	\$ (2.34)
Diluted	\$ 0.01	\$ (0.84)	\$ (3.21)	\$ (2.34)
Shares used in per share calculation				

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Basic	162,090	160,687	161,717	153,216
Diluted	173,925	160,687	161,717	153,216

- (1) The Statement of Operations for the three and nine months ended September 28, 2008 has been adjusted to reflect the change in accounting for the Company's Exchangeable Senior Subordinated Debentures as described in Note 3.
  - (2) Contractual interest expense for the three and nine months ended September 27, 2009 was \$21,073 and \$69,082, respectively.
- See accompanying notes**

**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Condensed Consolidated Balance Sheets****(in thousands)****(Unaudited)**

	<b>September 27, 2009</b>	<b>December 28, 2008 <sup>(1)</sup></b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 263,554	\$ 116,387
Auction rate securities	104,138	
Trade accounts receivable	118,754	134,347
Trade accounts receivable from related parties (Note 9)	310,045	111,448
Allowance for doubtful accounts	(55,052)	(10,354)
Other receivables		7,789
Other receivables from related parties (Note 9)		6,127
Inventories:		
Raw materials	11,243	16,305
Work-in-process	110,937	264,393
Finished goods	15,017	98,459
Total inventories	137,197	379,157
Deferred income taxes	3,213	3,213
Prepaid expenses and other current assets	66,201	35,225
Total current assets	948,050	783,339
Property, plant and equipment, net	343,140	795,030
Auction rate securities		94,014
Other assets	62,398	101,489
Total assets	\$ 1,353,588	\$ 1,773,872
<b>Liabilities and Stockholders Deficit</b>		
Current liabilities:		
Notes payable to banks under revolving loans	\$	\$ 105,687
Short term note	68,410	
Accounts payable	28,331	465,844
Accounts payable to related parties (Note 9)	146,440	74,592
Accrued compensation and benefits	16,814	60,412
Accrued liabilities to related parties (Note 9)		5,092
Other accrued liabilities	91,772	88,943
Income taxes payable	464	3,972
Deferred income	69,111	35,285
Current portion of long-term debt and obligations under capital leases		1,126,849
Total current liabilities	421,342	1,966,676
Deferred income taxes	3,280	3,267
Long-term debt, less current portion		210,246
Other long-term liabilities	27,015	44,330

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Total long-term liabilities	30,295	257,843
Liabilities subject to compromise	1,765,933	
Total liabilities	2,217,570	2,224,519
Stockholders' deficit	(863,982)	(450,647)
Total liabilities and stockholders' deficit	\$ 1,353,588	\$ 1,773,872

- (1) The Balance Sheet as of December 28, 2008 has been adjusted to reflect the change in accounting for the Company's Exchangeable Senior Subordinated Debentures as described in Note 3.

See accompanying notes

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

	<b>Nine Months Ended</b>	
	<b>September 27, 2009</b>	<b>September 28, 2008 <sup>(1)</sup></b>
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (518,388)	\$ (358,107)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, amortization, and in-process research and development write-off	140,288	501,194
Provision for doubtful accounts	18,477	525
Provision (benefit) for deferred income taxes	12	(793)
Net gain on sale and disposal of property, plant, and equipment	(1,372)	(19,910)
Gain on sale of marketable securities		(621)
Compensation recognized under employee stock plans	10,443	15,492
Gain on deconsolidation of subsidiary	(30,100)	
Gain on sale of Suzhou plant	(784)	
Loss from write-off of rejected capital leases and various licenses	3,090	
Changes in operating assets and liabilities, net of effects of deconsolidation of subsidiary:		
Increase in trade account receivables and other receivables	(180,852)	(1,232)
(Increase) decrease in inventories	185,096	(30,848)
(Increase) decrease in prepaid expenses and other current assets	(10,858)	1,121
Increase in other assets	(7,998)	(3,735)
Increase in accounts payable, accrued liabilities and accrued compensation	557,362	66,427
Decrease in income taxes payable	(2,327)	(13,210)
Increase in deferred income	16,000	12,752
<b>Net cash provided by operating activities</b>	<b>178,089</b>	<b>169,055</b>
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sale of property, plant and equipment	845	6,333
Purchases of property, plant and equipment	(15,647)	(396,697)
Proceeds from maturity and sale of marketable securities		133,695
Purchases of marketable securities		(36,950)
Proceeds from redemption of ARS	10,375	
Loan made to an investee	(5,263)	(4,125)
Cash proceeds from Saifun acquisition		733
Cash decrease due to deconsolidation of subsidiary	(52,092)	
Cash decreases to the sale of Suzhou plant	(10,431)	
<b>Net cash used by investing activities</b>	<b>(72,213)</b>	<b>(297,011)</b>
<b>Cash Flows from Financing Activities:</b>		
Proceeds from borrowings, net of issuance costs	117,758	250,559
Payments on debt and capital lease obligations	(73,372)	(162,278)



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Net cash provided by financing activities	44,386	88,281
Effect of exchange rate changes on cash and cash equivalents	(3,095)	(7,310)
Net (decrease) increase in cash and cash equivalents	147,167	(46,985)
Cash and cash equivalents at the beginning of period	116,387	199,092
 Cash and cash equivalents at end of period	 \$ 263,554	 \$ 152,107
 Non-cash investing and financing activities:		
Equipment capital leases	\$	\$ 50,474
Issuance of common stock and stock options to acquire Saifun	\$	108,898

- (1) The Statement of Cash Flows for the nine months ended September 28, 2008 has been adjusted to reflect the change in accounting for the Company's Exchangeable Senior Subordinated Debentures as described in Note 3.

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**Spansion Inc.**

**(Debtor-in-Possession)**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

Spansion Inc. (the Company) is a semiconductor manufacturer headquartered in Sunnyvale, California, with research and development, manufacturing and assembly operations in the United States, Middle East, Europe and Asia. The Company designs, develops, manufactures, markets, licenses and sells Flash memory technology and solutions.

The Company's Flash memory devices are used primarily to store microprocessor instructions (code), or code and data in embedded applications, and are incorporated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, data center servers, personal computers and PC peripheral applications.

**2. Creditor Protection Proceedings**

On February 10, 2009, Spansion Japan Limited (Spansion Japan), an indirectly wholly owned subsidiary of Spansion Inc., filed a proceeding under the Corporate Reorganization Law (Kaisha Kosei Ho) of Japan to obtain protection from Spansion Japan's creditors (the Spansion Japan Proceeding), and successively the Spansion Japan Proceeding was formally commenced on March 3, 2009 (the Commencement Date), when the Tokyo District Court entered the commencement order and appointed the incumbent representative director of Spansion Japan as trustee. On March 1, 2009 (the Petition Date), Spansion Inc., Spansion LLC, Spansion Technology LLC, Spansion International, Inc., and Cerium Laboratories LLC (collectively, the Debtors) each filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware (the Chapter 11 Cases). The Chapter 11 Cases are being jointly administered under Case No: 09-10690 (KJC). The Chapter 11 Cases, together with the Spansion Japan Proceeding are referred to collectively as the Creditor Protection Proceedings.

As required under the U.S. Bankruptcy Code, the United States Trustee for the District of Delaware (the Trustee) appointed an official committee of unsecured creditors on March 12, 2009 (the U.S. Creditors' Committee). In addition, a group purporting to hold substantial amounts of the Company's publicly traded Senior Secured Floating Rate Notes due 2013 has organized (the Floating Rate Noteholders). The role of the U.S. Creditors' Committee and the Floating Rate Noteholders in the Chapter 11 Cases may develop and change while the Chapter 11 Cases are pending, and there can be no assurance that either constituent will support the Company's positions on matters to be presented to the U.S. Bankruptcy Court or on any comprehensive plan of reorganization.

The Debtors continue to operate their businesses as debtors-in-possession under jurisdiction of the U.S. Bankruptcy Court and in accordance with the applicable provisions of the U.S. Bankruptcy Code and orders of the U.S. Bankruptcy Court. Non-U.S. subsidiaries that are not included in the Creditor Protection Proceedings (Non-Debtor Affiliates) continue to operate without the supervision of the U.S. Bankruptcy Court.

***Plan of Reorganization***

On October 26, 2009, the Company filed with the U.S. Bankruptcy Court a proposed Plan of Reorganization, together with an accompanying Disclosure Statement. On each of November 25, 2009 and December 9, 2009, the Company filed an amended proposed Plan of Reorganization together with an accompanying amended Disclosure Statement. The Plan of Reorganization provides for an equitable distribution to holders of allowed claims in certain classes of creditors, preserves the value of the Debtors

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**Spansion Inc.**

**(Debtor-in-Possession)**

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

**(Unaudited)**

businesses as going concerns and preserves many jobs of the Debtors' employees. The Plan of Reorganization, if accepted by the requisite majorities of one or more of the affected class of creditors and approved by the U.S. Bankruptcy Court, would be binding on all creditors within each affected class, including those that did not vote to accept the proposal. The ultimate recovery to creditors and security holders, if any, will not be determined until a plan of reorganization is approved and all claims have been finalized.

Under the proposed Plan of Reorganization, as amended, the Debtors will be reorganized (Reorganized Debtors) through the consummation of several transactions in which new securities of each Reorganized Debtor will be issued and distributed in accordance with the Plan of Reorganization. These transactions will include:

the distribution of cash, new senior notes and new convertible notes, or cash raised through a rights offering and/or debt issuance, providing that such cash is raised no later than February 12, 2010, to holders of the Company's existing Floating Rate Notes;

the distribution of new Spansion common stock to holders of general unsecured claims;

the cancellation of Spansion Inc.'s existing equity securities, including all shares of Class A Common Stock and existing options to purchase shares of Class A Common Stock; and

the retention of the assets of the Debtors in the reorganized Debtors.

The proposed Plan of Reorganization provides for the treatment of claims of creditors on a waterfall basis that allocates value to the Debtors' creditors and stockholders in accordance with the priorities of the Bankruptcy Code. Pursuant to the Plan of Reorganization, allowed administrative claims and priority tax claims would be paid in full in cash or cash equivalents. Other allowed secured claims would be reinstated, paid in full in cash or cash equivalents, or have the collateral securing such claims returned to the secured creditor. Allowed unsecured convenience claims (all claims \$2,000 or less) would be paid in full in cash or cash equivalents. Any remaining value would be distributed on a pro rata basis to holders of allowed unsecured claims in the form of new Spansion common stock. Under the proposed Plan of Reorganization, the Company's current stockholders will not be entitled to any recovery, making such shares of common stock valueless.

The proposed Plan of Reorganization assumes that allowed claims will range from approximately \$1.6 billion to approximately \$2.1 billion after completion of the claims objection, reconciliation and resolution process. In addition to the range specified above, Spansion Japan has asserted that it has been damaged as a result of the foundry agreement rejection in an amount up to \$1.0 billion, although it has not yet initiated action in court regarding this assertion. As of September 27, 2009 the Company has accrued expected allowed claims totaling approximately \$1.8 billion classified as liabilities subject to compromise in the accompanying balance sheet. If the expected amount of allowed claims increases over the amount currently accrued, the Company will record additional reorganization expense in the period of such determination. Because disputed claims, including litigation instituted by the Company challenging so-called make whole, premium, or no-call claims, have not yet been finally adjudicated, and the Debtors' total enterprise value upon emergence has not yet been finally determined, no assurances can be given that actual recoveries to creditors and interest holders will not be materially higher or lower than proposed in the Plan of Reorganization. The Disclosure Statement contains detailed information about the Plan of Reorganization, a historical profile of the Debtors' business, a description of proposed distributions to creditors, and an analysis of the Plan of Reorganization's feasibility, as well as many of the technical matters required for the exit process, such as descriptions of who will be eligible to vote on the Plan of Reorganization and the voting process itself. The information contained in the Disclosure Statement is subject to change, whether as a result of further amendments to the Plan of Reorganization, actions of third parties or otherwise.



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

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On December 18, 2009, the U.S. Bankruptcy Court approved the adequacy of the Disclosure Statement, the solicitation and notice procedures with respect to confirmation of the Plan of Reorganization and the form of various ballots and notices in connection therewith. The U.S. Bankruptcy Court established December 14, 2009, as the record date for determining eligibility to vote on the Plan of Reorganization. Nothing contained in this Report is intended to be, nor should it be construed as, a solicitation for a vote on the Plan of Reorganization.

The Plan of Reorganization will become effective only if it is confirmed by the U.S. Bankruptcy Court. The voting and objection deadline with respect to the Plan of Reorganization is scheduled for January 26, 2010. The confirmation hearing in the U.S. Bankruptcy Court is scheduled to begin on February 11, 2010. If the U.S. Bankruptcy Court confirms the Plan of Reorganization, the Debtors expect to emerge from Chapter 11 shortly thereafter. However, there can be no assurance that the Debtors will be successful in obtaining the necessary votes to approve the Plan of Reorganization, that the U.S. Bankruptcy Court will confirm the Plan of Reorganization or that it will be implemented successfully.

***Business Relationship with Spansion Japan and Foundry Agreement***

Spansion Japan Limited (Spansion Japan), a wholly-owned subsidiary of the Company, made filings for corporate reorganization proceedings on February 10, 2009, and formally commenced corporate reorganization proceedings in Japan on March 3, 2009. Spansion Japan is now managed by a trustee appointed by the Japanese Court and is subject to the general supervision of the Japanese Court and a court appointed supervisory attorney. As a result, and in accordance with U.S. GAAP, the financial results of Spansion Japan are no longer included in the consolidated financial results of the Company for periods beginning March 3, 2009. The effect of the deconsolidation at March 3, 2009 was a \$30.1 million gain representing the difference between the carrying value of the Company's investment in Spansion Japan and the fair value of the Company's retained non-controlling interest in Spansion Japan, which was valued at zero.

Spansion Japan facilitates distribution of the Company's products in Japan and also manufactures and supplies sorted and unsorted silicon wafers to the Company. The wafers purchased from Spansion Japan are a material component of the Company's cost of goods sold, and historically the wafer prices were governed by a pre-petition foundry agreement. For the reasons described in more detail below, the Company believes that the prices under the foundry agreement greatly exceed the amounts that the U.S. Bankruptcy Court will require the Company to pay for wafers purchased during the period from February 9, 2009 (20 days prior to the Petition Date) through October 27, 2009 (the date when the Company and Spansion Japan mutually agreed to pricing terms through executed purchase orders). Commencing no later than the Petition Date, the Company worked with Spansion Japan and its creditors to renegotiate wafer prices. The Company believed for a time that it had reached an agreement with Spansion Japan on new wafer prices and volumes, with retroactive effect to March 1, 2009. Subsequently, it became clear that Spansion Japan did not intend to honor the tentative agreement, which was never formalized. Further efforts by the Company to renegotiate the prices under the foundry agreement were unsuccessful and in October 2009, the Company filed a motion with the U.S. Bankruptcy Court to reject the foundry agreement. An order rejecting the foundry agreement was issued by the U.S. Bankruptcy Court on November 19, 2009. As a result, there is no valid contract establishing pricing for the wafers the Company has received from Spansion Japan from February 9, 2009 through October 27, 2009 (Disputed Period). The Company believes that under the U.S. Bankruptcy Code, Spansion Japan is only entitled to receive the actual, necessary costs and expenses of preserving the Company's bankruptcy estate. The Company

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

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believes that this means that Spansion Japan is only entitled to receive the value to the Company for wafers shipped during the Disputed Period. Accordingly, management estimated the value of the wafers purchased from Spansion Japan during this period based on: 1) the report of an independent consultant, 2) information from third party foundries interested in supplying the Company's wafer needs, 3) the terms of the mutually agreed pricing with Spansion Japan subsequent to October 27, 2009, and 4) the discussions with Spansion Japan to date to resolve the pricing dispute.

Management believes its estimates of value are reasonable and appropriate for wafers purchased during the Disputed Period. The condensed consolidated financial statements for the three and nine months ended September 27, 2009 included in this Report reflect the Company's estimates of value for goods and services provided by Spansion Japan since February 9, 2009. The U.S. Bankruptcy Court is scheduled to hear evidence to establish the value of wafers purchased during the Disputed Period from Spansion Japan on January 8, 2010. A negotiated settlement, or a finding by the U.S. Bankruptcy Court that the value of wafers purchased during the Disputed Period from Spansion Japan is different than the Company's estimates, may have an impact on the Company's results of operations and that impact could be material. Moreover, a settlement or ruling could also have a material impact on the financial condition of the Company, as described further below. For example, if the U.S. Bankruptcy Court were to determine that the value was equal to the pricing terms in the original foundry agreement, the Company estimates that its liability to Spansion Japan for wafer deliveries during the Disputed Period may be approximately \$180.0 million greater than the liability recorded by the Company using its estimates of wafer value over the same period.

As mentioned above, the Company no longer controls, but still uses Spansion Japan for wafer manufacturing and sort services to provide products to the Company's customers globally, and for distribution of its products to customers in Japan. Any of the trustee of Spansion Japan, the Tokyo District Court, the supervising attorney, or Spansion Japan's creditors could take actions that result in a reduction or elimination of the supply of those products and services to the Company. Moreover, the current deadline for Spansion Japan to submit a plan of reorganization to the Japanese Court is February 24, 2010. There can be no assurance that Spansion Japan's plan of reorganization will be approved, or that Spansion Japan will not be liquidated. As a result of these aforementioned risks, and also as a result of the protracted wafer pricing dispute mentioned above, the Company has been implementing plans to mitigate against the impact that would result if for any reason Spansion Japan reduced its supply of, or ceased supplying, the goods and services to the Company. Nevertheless, a sudden and unanticipated reduction or cessation of the supply of goods and services from Spansion Japan might be disruptive and have an adverse impact on the Company's results of operations and that impact could be material.

On September 24, 2009, GE Financial Services Corporation (the principal secured creditor of Spansion Japan), on its own behalf and on behalf of Spansion Japan's secured creditors, filed a motion asserting that the pricing for wafers shipped since the Petition Date should be governed by the foundry agreement and seeking an undetermined administrative expense claim. On September 28, 2009, the trustee of Spansion Japan filed a motion asserting that the original foundry agreement governs the pricing for wafers shipped to Spansion LLC since the Petition Date. Spansion Japan has also filed claims of approximately \$115.0 million for goods and services delivered to the Company pre-petition. Moreover, Spansion Japan has asserted that it has been damaged as a result of the foundry agreement rejection in an amount up to \$1.0 billion, although it has not yet initiated action in court regarding this assertion. The Company believes it has strong defenses to all of these assertions, and barring a negotiated settlement on acceptable terms, intends to vigorously contest these matters. An award of damages resulting from the rejection of the foundry agreement may result in a charge to earnings and a claim classified as a pre-petition liability which might entitle Spansion Japan to a pro-rata distribution of new Spansion common stock. A determination by the U.S. Bankruptcy Court that required additional payments to Spansion Japan for

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**Spansion Inc.**

**(Debtor-in-Possession)**

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

**(Unaudited)**

goods and services received after February 9, 2009 would be an administrative claim and accordingly would entitle Spansion Japan to a cash recovery. Such a determination might impact the results of operations and financial condition of the Company. Depending on the size of such an award, the impact could be material and render the current plan of reorganization infeasible, which could hinder or delay the Company's emergence from bankruptcy.

**3. Summary of Significant Accounting Policies**

***Basis of Presentation and Going Concern***

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 the Company's 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 to be expected for any subsequent interim period or for the full fiscal year ending December 27, 2009.

The commencement of the Creditor Protection Proceedings raises substantial doubt as to whether the Company will be able to continue as a going concern. The accompanying consolidated financial statements have been prepared using the same U.S. GAAP and the rules and regulations of the U.S. Securities and Exchange Commission (SEC) as applied by the Company prior to the Creditor Protection Proceedings. The accompanying consolidated financial statements continue to be prepared using the going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Chapter 11 Cases have provided the Company with a period of time to stabilize its operations and financial condition and to develop the proposed Plan of Reorganization. However, it is not possible to predict the outcome of these proceedings and, as such, the realization of assets and discharge of liabilities are each subject to significant uncertainty. Further, it is not possible to predict whether the actions taken in the proposed Plan of Reorganization or any other reorganization plan will result in improvements to the Company's financial condition sufficient to allow it to continue as a going concern. If the going concern basis is not appropriate in future filings, adjustments will be necessary to the carrying amounts and/or classification of the Company's assets and liabilities in its consolidated financial statements included in those filings. Further, an amendment to the Plan of Reorganization could materially change the carrying amounts and classifications reported in the accompanying consolidated financial statements in future filings.

The accompanying consolidated financial statements do not purport to reflect or provide for the outcome of the Chapter 11 Cases. In particular, such consolidated financial statements do not purport to show: (a) as to assets, their realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-petition liabilities, the amounts that will ultimately be allowed for claims or contingencies, or the status and priority thereof; (c) as to stockholders accounts, the effect of any changes that may be made in the Company's capitalization; or (d) as to operations, the effect of any changes that may be made in the Company's business.

The accompanying consolidated financial statements reflect the accounting, presentation, and disclosure requirements prescribed by American Institute of Certified Public Accountants Statement of Position (SOP) No. 90-7 (SOP 90-7), *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*, now codified in FASB Accounting Standards Codification (ASC) Topic 852,

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**(Debtor-in-Possession)**

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

**(Unaudited)**

*Reorganization* (ASC 852). Accordingly, liabilities and obligations whose treatment and satisfaction is dependent on the outcome of the Chapter 11 Cases have been segregated and classified as Liabilities Subject to Compromise in the consolidated balance sheet. The ultimate amount of and settlement terms for the Company's pre-petition liabilities are dependent on the outcome of the Chapter 11 Cases and, accordingly, are not presently determinable. Professional fees associated with the Chapter 11 Cases and certain gains and losses resulting from reorganization of the Company's business have been reported separately as reorganization items. In addition, interest expense has been reported only to the extent that it will be paid during the Chapter 11 Cases or that it is probable that it will be an allowed priority, secured or unsecured claim under the Chapter 11 Cases and interest income earned during the Chapter 11 Cases is reported as a reorganization item.

Furthermore, effective as of March 3, 2009, the Company no longer controls Spansion Japan due to the appointment of a trustee in the Spansion Japan Proceeding on March 3, 2009. Upon deconsolidation, the Company recorded a gain of \$30.1 million. The gain represents the difference between the carrying value of the Company's investment in Spansion Japan immediately before deconsolidation (100 percent of Spansion Japan's stockholder's deficit adjusted by the net receivables from Spansion Japan) and the estimated fair value of the Company's retained non-controlling interest in Spansion Japan (zero). Since March 3, 2009, the Company has accounted for its interest in Spansion Japan as a cost basis investment. The results of operations of Spansion Japan after March 3, 2009 are not included in the Company's condensed consolidated statement of operations and the carrying value of the cost basis investment at September 27, 2009 was zero. Transactions between the Company and Spansion Japan after March 3, 2009, have been reflected as transactions with a third party.

With the exception of Spansion Japan as described above, the condensed consolidated financial statements include all the accounts of the Company and those of its wholly owned subsidiaries, and 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 28, 2008 included in the Company's Annual Report on Form 10-K, filed with the SEC on May 7, 2009.

The Company uses a 52- to 53-week fiscal year ending on the last Sunday in December. The three months ended September 27, 2009 and September 28, 2008 both consisted of 13 weeks. The nine months ended September 27, 2009 and September 28, 2008 both consisted of 39 weeks.

***Use of Estimates***

The preparation of the Company's condensed consolidated 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. Estimates are used to account for the fair value of the retained non-controlling interest in Spansion Japan, the fair value of certain marketable securities, revenue, the allowance for doubtful accounts, inventory, including the value of inventory purchased from Spansion Japan, valuation of acquired intangible assets, impairment of long-lived assets, income taxes, stock-based compensation expenses, liabilities subject to compromise including debt subject to the requirements of FSP APB 14-1 (see below), product warranties, pension and postretirement benefits, and liability for wafer purchases from Spansion Japan. Actual results may differ from those estimates, and such differences may be material to the Company's consolidated financial statements.



**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)*****Adoption of New Accounting Pronouncement***

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1 (FSP APB 14-1), *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, now codified principally in ASC Topic 470, *Debt* (ASC 470). This accounting standard provides that issuers of such instruments should separately account for the liability and equity components of those instruments by allocating the proceeds at the date of issuance of the instrument between the liability component and the embedded conversion option (the equity component) by first determining the carrying amount of the liability. To calculate this amount, the Company must determine the fair value of the liability excluding the embedded conversion option and by giving effect to other substantive features, such as put and call options, and then allocating the excess of the initial proceeds to the embedded conversion options. The excess of the principal amount of the liability component over its carrying amount is reported as a debt discount and is amortized as interest expense over the expected life of the instrument.

The Company retrospectively adopted FSP APB 14-1, which impacted the Company's accounting for Exchangeable Senior Subordinated Debentures, issued in June 2006. The Exchangeable Senior Subordinated Debentures bear interest at 2.25 percent per annum, payable on June 15 and December 15 of each year beginning December 15, 2006 until the maturity date of June 15, 2016. As a result of adopting FSP APB 14-1, the Company recorded an equity component of \$117.4 million, representing the fair value of the embedded conversion options, and a liability component of \$89.6 million, representing the fair value of the debentures as of the date issuance. The net carrying amount of the liability component of the Exchangeable Senior Subordinated Debentures was included in liabilities subject to compromise at September 27, 2009 and current portion of long-term debt and obligations under capital leases at December 28, 2008.

The table below shows the components of the net carrying amount of the liability portion of the Exchangeable Senior Subordinated Debentures at September 27, 2009 and at December 28, 2008:

	September 27, 2009	December 28, 2008
	(in thousands)	
Principal amount of liability component	\$ 207,000	\$ 207,000
Unamortized discount	(97,767)	(99,241)
Net carrying amount	\$ 109,233	\$ 107,759

As a result of adopting FSP APB 14-1, the Company recorded additional non-cash interest expense resulting from recognizing the accretion of the discounted carrying value of the Exchangeable Senior Subordinated Debentures to their face amount as interest expense over the term of the debt, which matures on June 15, 2016. However, pursuant to the accounting guidance for entities in reorganization, interest expense recorded subsequent to March 1, 2009 only includes amounts expected to be actually paid during the Creditor Protection Proceedings, and as a result amortization of the discounted carrying value ceased.

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

The following represents the components of interest expense and effective interest rates relating to the Exchangeable Senior Subordinated Debentures:

	Three Months Ended		Nine Months Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
	(in thousands)			
Contractual interest expense	\$	\$ 1,020	\$ 806	\$ 3,375
Amortization of discount		2,148	1,475	5,900
<b>Total interest expense</b>	<b>\$</b>	<b>\$ 3,168</b>	<b>\$ 2,281</b>	<b>\$ 9,275</b>

Effective interest rate 12.23% 12.23% 12.23% 12.23%

For the three and nine months ended September 27, 2009, the effect of applying the provisions of FSP APB 14-1, was an increase in non-cash interest expense of zero and \$1.5 million, respectively, which represents accretion of the unamortized debt discount associated with the Exchangeable Senior Subordinated Debentures, partially offset by lower amortization of capitalized issuance costs as a portion of these were allocated to equity.

The following tables show the financial statement line items affected by retrospective application of FSP APB 14-1 on the affected financial statement line items for the periods indicated:

**Consolidated Statements of Operations****(in thousands, except per share amounts)**

	December 28, 2008		Years Ended December 30, 2007			
	As Adjusted under FSP APB 14-1	As reported	Effect of Change	As Adjusted under FSP APB 14-1	As reported	Effect of Change
Interest expense	\$ (105,536)	\$ (97,843)	\$ (7,693)	\$ (87,460)	\$ (80,803)	\$ (6,657)
Other income (expense), net	(100,336)	(92,643)	(7,693)	(54,865)	(48,208)	(6,657)
Loss before income taxes	(2,372,147)	(2,364,454)	(7,693)	(295,297)	(288,640)	(6,657)
Net loss	(2,435,012)	(2,427,319)	(7,693)	(270,153)	(263,496)	(6,657)
Net loss per share:						
Basic and diluted	\$ (15.69)	\$ (15.64)	\$ (0.05)	\$ (2.00)	\$ (1.95)	\$ (0.05)
Shares used in per share calculation:						
Basic and diluted	155,162	155,162		134,924	134,924	

**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)****Condensed Consolidated Statements of Operations****(in thousands, except per share amounts)**

	<b>Three Months Ended September 28, 2008</b>			<b>Nine Months Ended September 28, 2008</b>		
	<b>As Adjusted under FSP APB 14-1</b>	<b>As Previously Reported</b>	<b>Effect of Change</b>	<b>As Adjusted under FSP APB 14-1</b>	<b>As Previously Reported</b>	<b>Effect of Change</b>
Interest expense	\$ (26,949)	\$ (24,853)	\$ (2,096)	\$ (79,249)	\$ (73,507)	\$ (5,742)
Other expense, net	(40,035)	(37,939)	(2,096)	(86,420)	(80,678)	(5,742)
Loss before income taxes	(125,764)	(123,668)	(2,096)	(350,912)	(345,170)	(5,742)
Net loss	(135,347)	(133,251)	(2,096)	(358,107)	(352,365)	(5,742)
<b>Net loss per common share:</b>						
Basic and diluted	\$ (0.84)	\$ (0.83)	\$ (0.01)	\$ (2.34)	\$ (2.30)	\$ (0.04)
<b>Shares used in per share calculation:</b>						
Basic and diluted	160,687	160,687	160,687	153,216	153,216	153,216

**Consolidated Balance Sheet****(in thousands)**

	<b>December 28, 2008</b>		
	<b>As Adjusted under FSP APB 14-1</b>	<b>As Previously Reported</b>	<b>Effect of Change</b>
Other assets <sup>(1)</sup>	\$ 101,489	\$ 103,061	\$ (1,572)
Total assets	1,773,872	1,775,444	(1,572)
Current portion of long-term debt <sup>(2)</sup>	1,087,786	1,187,027	(99,241)
<b>Stockholders' deficit:</b>			
Additional paid-in capital <sup>(3)</sup>	2,471,902	2,356,629	115,273
Accumulated deficit <sup>(4)</sup>	(2,997,589)	(2,979,985)	(17,604)
Total stockholders' deficit	(450,647)	(548,316)	97,669
Total liabilities and stockholders' deficit	1,773,872	1,775,444	(1,572)

(1) The effect of the change on other assets includes the allocation of a portion of the capitalized issuance costs to the equity component of \$2.1 million, offset by lower amortization of these costs from the issuance date of \$0.5 million.

(2) The effect of the change on current portion of long-term debt includes the discount determined as of the original issuance date of the Exchangeable Senior Subordinated Debentures of \$117.4 million, less amortization of the discount from the issuance date of \$18.1 million.

(3)

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The effect of the change on paid-in capital includes the discount determined as of the original issuance date of the Exchangeable Senior Subordinated Debentures of \$117.4 million, less the portion of the original debt issuance costs allocated to the equity component of \$2.1 million.

- (4) The effect of the change on accumulated deficit includes the amortization of the discount from the issuance date of \$18.1 million, less adjustment to the amortization of debt issuance costs of \$0.5 million.

**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)*****New Accounting Pronouncements***

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162* (Statement 168). Statement 168 replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* and establishes the FASB Accounting Standards Codification<sup>TM</sup> (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. generally accepted accounting principles. All guidance contained in the Codification carries an equal level of authority. On the effective date of SFAS 168, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

In May 2009, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 165, Subsequent Events, now codified in ASC Topic 855, *Subsequent Events*. This accounting standard establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued and is effective for interim or annual period ending after June 15, 2009. The Company adopted this accounting standard during its second quarter of fiscal 2009 and its adoption did not impact the Company's financial position or results of operations. The Company evaluated all events or transactions that occurred after September 27, 2009 up through December 31, 2009, the date that the Company filed its Quarterly Report on Form 10-Q for the third quarter of fiscal year 2009.

**4. Reorganization Items**

Entities in reorganization are required to disclose expenses such as professional fees directly related to the process of reorganizing the Debtors under the Chapter 11 Cases, realized gains and losses, provisions for losses, and interest income resulting from the reorganization and restructuring of the business to be separately disclosed. The Debtors' reorganization items for the three and nine months ended September 27, 2009 consist of the following:

	<b>Three Months Ended September 27, 2009</b>	<b>Nine Months Ended September 27, 2009</b>
	<b>(in thousands)</b>	
Professional fees directly related to reorganization <sup>(1)</sup>	\$ 8,736	\$ 25,851
Provision for expected allowed claims <sup>(2)</sup>	837	356,170
Interest income	(225)	(373)
Total reorganization items	\$ 9,348	\$ 381,648

(1) Includes fees associated with the advisors to the Debtors.

(2) Represents the Company's estimate of the expected allowed claims related primarily to rejection or repudiation of executory contracts, leases, and the effects of approved settlements.

The U.S. Bankruptcy Court established September 4, 2009, as the bar date for filing proofs of claim against the U.S. Debtors' estates. Under certain limited circumstances, some creditors will be permitted to file claims after the applicable bar dates. Accordingly, it is possible that not all potential claims were filed as of the filing of this document. The differences between amounts recorded by the U.S. Debtors and proofs of claim

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filed by the creditors are investigated and resolved through the claims reconciliation process. Because of the number of creditors and claims, the claims reconciliation process may take considerable time to complete and the Company expects it will continue to receive claims after its emergence from Chapter 11.

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

Notwithstanding the foregoing, the Company has recognized certain charges related to allowed claims or expected allowed claims. The U.S. Bankruptcy Court will ultimately determine liability amounts that will be allowed for claims. As claims are resolved, or where better information becomes available and is evaluated, the Company will make adjustments to the liabilities recorded on its interim or annual financial statements as appropriate. Any such adjustments could be material to the Company's financial position or results of operations in any given period.

Cash paid for professional fees was approximately \$8.4 million and \$23.7 million, respectively, for the three and nine months ended September 27, 2009.

**5. Liabilities Subject to Compromise**

Liabilities subject to compromise refers to both secured and unsecured obligations that will be accounted for under a plan of reorganization. Generally, actions to enforce or otherwise effect payment of pre-petition liabilities are stayed. The U.S. Bankruptcy Court has, however, approved payment of certain of the Debtors pre-petition obligations, including among other things employee wages, salaries and benefits and certain business-related payments such as claims of transport companies and certain contractors in satisfaction of liens or other interests. The Debtors have been paying and continue to pay undisputed post-petition claims in the ordinary course of business.

Pre-petition liabilities that are subject to compromise are reported at the amounts expected to be allowed, even if they may be settled for lesser amounts. These liabilities represent the estimated amount expected to be allowed on known or potential claims to be resolved through the Chapter 11 Cases, and remain subject to future adjustments arising from negotiated settlements, actions of the U.S. Bankruptcy Court, rejection of executory contracts and unexpired leases, the determination as to the value of collateral securing the claims, proofs of claim, or other events. Liabilities subject to compromise also includes certain items that may be assumed under the plan of reorganization, and as such, may be subsequently reclassified to liabilities not subject to compromise. Ordinarily, secured debt is not considered to be a liability subject to compromise. However, the Company has included most of its secured debt as a liability subject to compromise as management believes that there remains uncertainty as to whether such debts are adequately secured.

The Debtors may reject pre-petition executory contracts and unexpired leases with respect to the Debtors' operations, with the approval of the U.S. Bankruptcy Court. During the first and second quarter of 2009, the Company submitted various motions to the U.S. Bankruptcy Court for rejection of certain equipment leases with future principal and interest payments of approximately \$54.5 million through 2011, all of which has been approved by the U.S. Bankruptcy Court as of August 10, 2009. Damages resulting from rejection of executory contracts and unexpired leases are generally treated as general unsecured claims and will be classified as liabilities subject to compromise. Holders of pre-petition claims were required to file proofs of claims by September 4, 2009. Differences between liability amounts estimated by the Debtors and claims filed by creditors will be investigated and, if necessary, the U.S. Bankruptcy Court will make a final determination of the allowable claim. The determination of how liabilities will ultimately be treated cannot be made until the U.S. Bankruptcy Court approves the Company's plan of reorganization. Accordingly, the ultimate amount or treatment of such liabilities is not determinable at this time. Liabilities subject to compromise consist of the following:

	<b>September 27, 2009</b>
	<b>(in thousands)</b>
Accounts payable and accrued liabilities	\$ 640,380
Accounts payable to related parties	109,941
Accrued compensation and benefits	19,538
Long-term debt	968,266
Capital lease obligations	23,774
Other long-term liabilities	4,034

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Total liabilities subject to compromise	\$	1,765,933
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**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)****6. Stock-Based Compensation****Shares Available to Grant**

The numbers of shares of Class A Common Stock available for grant at September 27, 2009 under the Spansion Inc. 2007 Equity Incentive Plan (the 2007 Plan), the Spansion Inc. 2005 Equity Incentive Plan (the 2005 Plan) and the Saifun Semiconductors Ltd. 2003 Employee Share Option Plan (the Saifun 2003 Plan) are shown in the following table:

Number of shares available for grant:	
Shares reserved for grant <sup>(1)</sup>	12,126,424
Shares available under the 2007 Plan (transferred from the 2005 Plan)	1,753,575
Stock options granted through September 27, 2009, net of cancelled stock options	(4,398,242)
RSU awards granted through September 27, 2009, net of cancelled RSU awards	(1,259,428)
Shares available for grant under the 2007 Plan and Saifun 2003 Plan	8,222,329

<sup>(1)</sup> The 12,126,424 shares reserved for grant consisted of 6,675,000 shares approved for grant under the 2007 Plan, 920,523 shares transferred from the 2005 Plan and 4,530,901 shares transferred from the Saifun 2003 Plan.

**Valuation and Expense Information**

The following table sets forth the total recorded stock-based compensation expense for the 2005 Plan, 2007 Plan, Saifun 2003 Plan, Saifun Semiconductor Ltd. 2001 Share Option Plan and Saifun Semiconductor Ltd. 1997 Share Option Plan (collectively, the Spansion and Saifun Equity Plans) by financial statement caption, resulting from the Company's stock options and restricted stock unit (RSU) awards for the three and nine months ended September 27, 2009 and September 28, 2008:

	Three Months Ended		Nine Months Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
	(in thousands)			
Cost of sales	\$ 578	\$ 1,350	\$ 2,380	\$ 3,854
Research and development	812	1,699	3,198	4,522
Sales, general and administrative	1,485	2,505	4,865	7,116
Stock-based compensation expense before income taxes	2,875	5,554	10,443	15,492
Income tax benefit <sup>(1)</sup>				
Stock-based compensation expense after income taxes <sup>(1)</sup>	\$ 2,875	\$ 5,554	\$ 10,443	\$ 15,492

- (1) 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.

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

No stock options were granted in the three and nine months ended September 27, 2009 under the Spansion and Saifun Equity Plans. No stock options were granted in the three months ended September 28, 2008 under the Spansion and Saifun Equity Plans. The weighted average fair value of the Company's stock options granted in the nine months ended September 28, 2008 under the Spansion and Saifun Equity Plans was \$1.89 per share. The fair value of each stock option granted was estimated at the date of grant using a Black-Scholes-Merton option pricing model, with the following assumptions for grants:

	<b>Three Months Ended September 28, 2008</b>	<b>Nine Months Ended September 28, 2008</b>
Expected volatility	54.13%	48.66%
Risk-free interest rate	3.06%	2.67%
Expected term (in years)	4.61	5.05
Dividend yield	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 historical volatility since its initial public offering in December 2005 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 simplified method for developing the estimate of the expected life of a plain vanilla stock option except for options granted to Saifun on the date of acquisition for which expected term was based on historical option exercise activity. 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.

The Company measures stock-based compensation expense by applying an estimated forfeiture rate to the fair value of an option grant determined using the Black-Scholes-Merton method described above. The Company estimates forfeitures based on its historical forfeiture rates, which are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive the Company's best estimate of awards ultimately expected to vest.

As of September 27, 2009, the total unrecognized compensation cost related to unvested stock options and RSU awards under the Spansion and Saifun Equity Plans was approximately \$21.7 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2012.

**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)****Stock Option and Restricted Stock Unit Activity**

The following table summarizes stock option activity and related information under the Spansion and Saifun Equity Plans for the periods presented:

	Number of Shares	Average Exercise Price	Remaining Contractual Life (in years)	Intrinsic Value (in thousands)
<b>Options:</b>				
Outstanding as of December 30, 2007	3,536,968	\$ 11.53	5.66	\$
Granted <sup>(1)</sup>	6,806,119	\$ 1.48		
Cancelled	(537,156)	\$ 6.32		
Exercised	(26,534)	\$ 0.08		
Outstanding as of December 28, 2008	9,779,397	\$ 4.85	6.42	\$ 675
Granted		\$		
Cancelled	(2,924,768)	\$ 3.96		
Exercised	(197,951)	\$ 0.03		
Outstanding as of September 27, 2009 <sup>(2)</sup>	6,656,678	\$ 5.39	4.96	\$ 625
Exercisable as of September 27, 2009 <sup>(3)</sup>	3,888,078	\$ 6.99	3.93	\$ 283

(1) The number of options granted during the year ended December 28, 2008 includes 4,364,829 shares of options granted in March 2008 under Saifun Option Plans in accordance with the provisions of Saifun Acquisition Agreement.

(2) The number of options outstanding as of September 27, 2009 includes 349,090 shares of options held by Spansion Japan employees.

(3) The number of options exercisable as of September 27, 2009 includes 271,338 shares of options held by Spansion Japan employees. The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$0.30 as of September 25, 2009, the last trading day prior to September 27, 2009, 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 activities and related information for the periods presented:

	Number of Shares	Weighted-Average Grant-date Fair Value
<b>Restricted Stock Units:</b>		
Unvested as of December 30, 2007	3,153,426	\$ 11.33

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Granted	1,916,180	\$	2.93
Cancelled	(400,909)	\$	8.74
Vested	(1,368,132)	\$	11.51
Unvested as of December 28, 2008	3,300,565	\$	6.69
Granted			
Cancelled	(1,187,663)	\$	6.30
Vested	(883,629)	\$	8.38
Unvested as of September 27, 2009 <sup>(1)</sup>	1,229,273	\$	5.86

(1) The number of restricted stock units unvested as of September 27, 2009 includes 105,820 shares held by Spansion Japan employees.

**Table of Contents****Spansion Inc.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)****7. Net Income (Loss) Per Share**

The following table presents the calculation of basic and diluted net income per share:

	Three Months Ended		Nine Months Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
	<b>In thousands except for per-share amounts</b>			
Net income (loss)	\$ 1,500	\$ (135,347)	\$ (518,388)	\$ (358,107)
Weighted-average shares basic	162,090	160,687	161,717	153,216
Effect of dilutive potential common shares	11,835			
Weighted-average shares diluted	173,925	160,687	161,717	153,216
Net income (loss) per share basic	\$ 0.01	\$ (0.84)	\$ (3.21)	\$ (2.34)
Net income (loss) per share diluted	\$ 0.01	\$ (0.84)	\$ (3.21)	\$ (2.34)

Employee equity share options, unvested shares, and similar equity instruments granted by the Company are treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options and unvested restricted stock and restricted stock units which is calculated based on the average share price for each fiscal period using the treasury stock method, as well as the effect of the Company's Exchangeable Senior Subordinated Debentures. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares. The Company had 207,000 Exchangeable Senior Subordinated Debentures outstanding at September 27, 2009, with each debenture exchangeable into 56.7621 shares of the Company's Class A common stock.

The Company excluded approximately 7.8 million and 19.6 million of potential common shares for three and nine months ended September 27, 2009 and excluded approximately 25.3 million of potential common shares for the three and nine months ended September 28, 2008 from its diluted per share calculation, as the inclusion would be antidilutive.

**8. Comprehensive Loss**

The following are the components of comprehensive loss:

	Three Months Ended		Nine Months Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
	<b>(in thousands)</b>			
Net income ( loss)	\$ 1,500	\$ (135,347)	(518,388)	\$ (358,107)

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Net change in pension plan, net of taxes	155	123	(442)	
Net change in cumulative translation adjustment	3,452	(25,073)	33,779	
Net change in unrealized losses on marketable securities, net of \$0 taxes	12,242	(449)	(515)	
Total comprehensive income (loss)	\$ 1,500	\$ (119,498)	(543,787)	\$ (325,285)

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**Table of Contents**

**Spansion Inc.**

**(Debtor-in-Possession)**

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

**(Unaudited)**

**9. Related Party Transactions**

***Spansion Japan***

As discussed in Note 3, in the section entitled, Basis of Presentation and Going Concern, the Company does not include Spansion Japan in its consolidated financial statements after March 3, 2009, and since that date, has accounted for its interest in Spansion Japan as a cost basis investment. Due to its 100 percent non-controlling ownership interest in Spansion Japan, the Company is treating Spansion Japan as a related party for financial reporting purposes. The significant arrangements between the Company and Spansion Japan are as follows:

A foundry agreement whereby Spansion Japan manufactures wafers for the Company based on a five-quarter rolling production forecast. In exchange, the Company reimburses Spansion Japan for its manufacturing cost, plus a surcharge of 6 percent. Upon a motion by the Company, this foundry agreement was rejected by the U.S. Bankruptcy Court on November 19, 2009. For more information on this foundry agreement and related matters, see Note 2.

A supply agreement whereby the Company purchases foundry products from Spansion Japan that Spansion Japan purchases from Fujitsu.

A distribution agreement whereby Spansion Japan sells products that it purchases from the Company to Fujitsu. The transfer price between the companies is set such that Spansion Japan earns an approximately five percent gross profit margin on such sales.

A loan agreement whereby Spansion Japan has borrowed \$67.5 million from the Company. Interest accrues at a rate of TIBOR plus one percent and is payable annually. The Spansion Japan Proceedings constitutes an event of default, which has resulted in the outstanding balance becoming immediately due and payable.

A research and development agreement whereby Spansion Japan provides research, design and development services to the Company related to the design of the Company's products. In exchange the Company reimburses Spansion Japan for costs that Spansion Japan incurs in providing such services, plus a surcharge of 6 percent.

At March 3, 2009, the Company's receivables from Spansion Japan exceeded its payable to Spansion Japan. Upon deconsolidation, and based on its expectations regarding the potential resolution of the Spansion Japan Proceedings and the Chapter 11 Cases, the Company wrote down the amounts due from Spansion Japan, including the entire \$67.5 million due pursuant to the loan agreement, to an amount equal to the amount due to Spansion Japan at March 3, 2009. The associated charge for that write-down is included in the gain on deconsolidation. Also, in light of the rejection of the foundry agreement, the Company believes that Spansion Japan would merely have a claim for the value of goods and services provided to the Company and that any such claim would be subject to offset due to amounts that Spansion Japan owes to the Company.



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The following tables present the significant related party transactions and account balances between the Company and Spansion Japan for the three months ended September 27, 2009 and period from March 3, 2009 to September 27, 2009 and as of September 27, 2009:

	<b>Three Months Ended Sep. 27, 2009 (in thousands)</b>	<b>March 3, 2009 to Sep. 27, 2009 (in thousands)</b>
Net sales to Spansion Japan		
Finished goods and wafer sales	\$ 65,505	238,628
Royalty income	33	84
	\$ 65,538	238,712
Cost of sales:		
Wafer purchases	\$ 83,787	179,626
Reimbursement of employee related costs		(395)
Other costs	62	66
	\$ 83,849	179,297
Service fees (from) to Spansion Japan:		
Research and development services fee to Spansion Japan, net of reimbursement of employee related costs	\$ 5,331	13,146
Sales, general and administrative expenses from Spansion Japan, and reimbursement of employee related costs	(144)	(374)
	\$ 5,187	12,772
		<b>September 27, 2009 (in thousands)</b>
Trade accounts receivable from Spansion Japan	\$	310,045
Trade accounts payable to Spansion Japan	\$	(256,381)

**Fujitsu**

Fujitsu Limited (Fujitsu) is a holder of greater than 10 percent of the Company's voting securities as of September 27, 2009. Prior to the fourth quarter of fiscal 2008, the Company relied on Fujitsu as a sole distributor of its products and, historically, has entered into significant arrangements and transactions with Fujitsu through Spansion Japan. As a result of the deconsolidation of Spansion Japan discussed above, the Company did not have significant transactions with Fujitsu for the period from March 3, 2009 to September 27, 2009. Accordingly, the following information does not include transactions between Spansion Japan and Fujitsu between March 3, 2009 and September 27, 2009.

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Spansion Japan receives certain administrative services from Fujitsu. The charges for these services are negotiated annually between Spansion Japan and Fujitsu based on expected requirements and the estimated future costs of the services to be provided. Fujitsu provides foundry services to Spansion Japan since consummation of the sale of two Spansion Japan's wafer fabrication facilities located in Aizu-Wakamatsu, Japan (the JV1/JV2 Transaction) on April 2, 2007. Spansion LLC purchases non-Flash memory die from Fujitsu, for inclusion in some of the Company's multichip package (MCP) Flash memory solutions.

The Company entered into a five-year License Settlement Agreement with Fujitsu on September 11, 2008, which resulted in the payment to Fujitsu by the Company of quarterly royalties based on certain percentage thresholds of actual sales of the Company's Flash memory products (minus sales by Fujitsu to Spansion Japan under its existing Foundry Agreement for wafers which are

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

incorporated into Spansion's Flash memory products and to be sold by Spansion Japan to Fujitsu under the existing Distribution Agreement), subject to a maximum amount of \$10 million over the five-year term. These royalty payments are recognized in cost of sales in the Company's statements of operations.

The following tables present the significant related party transactions between the Company and Fujitsu for the three months ended September 27, 2009 and the three months ended September 28, 2008:

	Three Months Ended		Nine Months Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
	(in thousands)			
Net sales to Fujitsu	\$	\$ 156,690	\$ 50,208	\$ 513,232
Cost of sales:				
Royalties to Fujitsu	\$	\$ 883	\$	\$ 2,451
Other purchases of goods and services from Fujitsu and rental expense to Fujitsu		19,580	11,617	59,905
Subcontract manufacturing and commercial die purchases from Fujitsu		1,693	569	6,856
Wafer purchases, processing and sort services from Fujitsu <sup>(1)</sup>		56,588	6,096	186,329
Net gain recognized on sale of assets to Fujitsu on April 2, 2007 <sup>(1)</sup>		(8,192)	(3,075)	(25,238)
Reimbursement on costs of employees seconded to Fujitsu <sup>(1)</sup>		(7,454)	(2,633)	(21,483)
Pension curtailment loss <sup>(1)</sup>				
Equipment rental income from Fujitsu <sup>(1)</sup>		(819)	(186)	(2,790)
Administrative services income from Fujitsu <sup>(1)</sup>		(93)	(68)	(1,180)
	\$	\$ 62,186	\$ 12,320	\$ 204,850
Service fees to Fujitsu:				
Cost of sales	\$	\$ 9	\$	\$ 28
Research and development				10
Sales, general and administrative		148	110	453
Service fees to Fujitsu	\$	\$ 157	\$ 110	\$ 491

(1) These amounts relate to the JV1/JV2 Transaction.

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The account balances between the Company and Fujitsu as of September 27, 2009 were not material. The following table presents the account balances between the Company and Fujitsu as of December 28, 2008:

	<b>December 28, 2008</b>
	<b>(in thousands)</b>
Trade accounts receivable from Fujitsu	\$ 111,448
Other receivables from Fujitsu	\$ 6,127
Accounts payable to Fujitsu	\$ 74,592
Royalties payable to Fujitsu	\$ 1,617
Accrued liabilities to Fujitsu	\$ 3,475

**10. 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 27, 2009 and September 28, 2008 are as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 27,</b>	<b>September 28,</b>	<b>September 27,</b>	<b>September 28,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>			
Balance, beginning of period	\$ 2,905	\$ 1,489	\$ 1,489	\$ 1,305
Provision for warranties issued	287	4,274	2,158	11,296
Settlements	(290)	(3,912)	(794)	(11,232)
Changes in liability for pre-existing warranties during the period	(456)	(362)	(407)	120
Balance, end of period	\$ 2,446	\$ 1,489	\$ 2,446	\$ 1,489

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 party 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.****(Debtor-in-Possession)****Notes to Condensed Consolidated Financial Statements-(Continued)****(Unaudited)****11. Debt and Capital Lease Obligations**

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

	September 27, 2009	December 28, 2008
	(in thousands)	
Debt obligations:		
Senior Notes	\$ 233,440	\$ 233,025
Spansion Penang Loan		138
Exchangeable Senior Subordinated Debentures	109,233	107,759
Spansion Japan 2007 Credit Facility		287,963
Senior Secured Floating Rate Notes	625,593	625,617
Senior Secured Revolving Credit Facility		34,000
Spansion Japan 2007 Revolving Credit Facility		71,687
UBS Loan Secured by Auction Rate Securities	68,410	
Obligations under capital leases	23,774	82,593
<b>Total debt and capital lease obligations</b>	<b>1,060,450</b>	<b>1,442,782</b>
Less: amount subject to compromise	992,040	
<b>Total debt and capital lease obligations not subject to compromise</b>	<b>68,410</b>	<b>1,442,782</b>
Less: current portion	68,410	1,232,536
<b>Long-term debt and capital lease obligations not subject to compromise</b>	<b>\$</b>	<b>\$ 210,246</b>

Under terms of the Senior Notes, Exchangeable Senior Subordinated Debentures and Senior Secured Floating Rate Notes, the Chapter 11 Cases constituted an event of default and all amounts outstanding under these facilities were accelerated and became immediately due and payable.

**New Debt and Capital Lease Obligations and Activities for the nine months ended September 27, 2009:***Senior Secured Revolving Credit Facility*

In February 20, 2009, the Company repaid the outstanding balance under this facility in full.

*Union Bank of Switzerland (UBS AG) Loan Secured by Auction Rate Securities*

On December 29, 2008, the Company entered into a Credit Line Agreement (the UBS Credit Line) with UBS that provides up to an aggregate amount of up to \$85.0 million in the form of an uncommitted revolving line of credit, which is secured by the auction rate securities currently held by the Company. Variable rate advances under the UBS Credit Line will bear interest at a variable rate equal to the lesser of: (a) LIBOR, plus a percentage rate between 1.250 percent to 2.750 percent, depending on the amount of the advance, and (b) the then applicable weighted

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average rate of interest or dividend rate paid to the Company by the issuer of the auction rate securities, and in each case, such interest rate is subject to adjustment at any time and from time to time to reflect changes in the composition of the auction rate securities.

The UBS Credit Line also provides, among other things, that:

UBS may demand full or partial payment of the credit line at its sole discretion and without cause at any time; and

UBS may at any time in its sole discretion terminate and cancel the credit line;

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

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provided, however, that UBS is required to provide to the Company alternative financing on substantially similar terms, unless the demand right was exercised as a result of certain specified events (including the Chapter 11 Cases) or the customer relationship between UBS and the Company is terminated for cause by UBS.

As of September 27, 2009, the amount outstanding under the UBS Loan was approximately \$68.4 million, which is the maximum amount available. This amount bears interest at approximately 1.3 percent as of September 27, 2009.

***Spansion Japan Obligations***

As discussed in Note 3, effective March 3, 2009, the Company no longer consolidates Spansion Japan. Accordingly, the obligations related to the Spansion Japan 2007 Credit Facility and the Spansion Japan 2007 Revolving Credit Facility are not included in the Company's consolidated balance sheet at September 27, 2009.

***Obligations under Capital Leases***

During the first and second quarter of 2009, the Company submitted various motions to the U.S. Bankruptcy Court seeking rejection of certain equipment leases with future principal and interest payments of approximately \$54.5 million through 2011, all of which have been approved by the Court as of August 10, 2009.

***Impact of Chapter 11 Cases***

As discussed in Note 3, the accounting guidance for entities in reorganization provides that interest should be reported only to the extent that it will be paid during the proceeding or that it is probable that it will be an allowed priority, secured, or unsecured claim. On that basis, the Company ceased accruing interest as of the Petition Date on its Senior Notes and Exchangeable Senior Subordinated Debentures. In addition, accretion of the discounted carrying value of the Exchangeable Senior Subordinated Debenture ceased on March 1, 2009. For the three months ended September 27, 2009, the Company reported interest expense was approximately \$9.2 million while contractual interest was approximately \$21.1 million. For the nine months ended September 27, 2009, reported interest expense was approximately \$42.9 million while contractual interest was approximately \$69.1 million.

**12. Income Taxes**

The Company recorded income tax expenses of \$0.5 million in the three months ended September 27, 2009 as compared to income tax expenses of \$9.6 million in the three months ended September 28, 2008. The income tax expense recorded in the three months ended September 27, 2009 was primarily related to tax provision in profitable foreign locations of \$0.5 million. The income tax expense recorded in the three months ended September 28, 2008 was primarily related to tax provisions in profitable foreign locations, of which \$9.9 million was associated with profits in Japan. The income tax expense of \$9.9 million associated with Japan was due to a \$3.1 million reduction in income tax payable and a \$13.0 million reduction in deferred tax assets.

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The Company recorded income tax expenses of \$0.9 million in the nine months ended September 27, 2009 as compared to income tax expenses of \$7.2 million in the nine months ended September 28, 2008. The income tax expense recorded in the nine months ended September 27, 2009 was primarily related to tax provisions in profitable foreign locations of \$0.9 million. The income tax expense recorded in the nine months ended September 28, 2008 was primarily related to a tax provision of \$4.5 million associated with profits in Japan, and by tax provisions in other profitable foreign locations of \$2.7 million.

As of September 27, 2009, all of the Company's U.S. and foreign deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance. The realization of these assets is dependent on substantial future taxable income which at September 27, 2009, in management's estimate, is not more likely than not to be achieved.

**13. Fair Value**

As of September 27, 2009, the fair value measurements of the Company's financial assets consisted of the following and which are categorized in the table below based upon the fair value hierarchy:

	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	September 27, 2009				December 28, 2008			
	(in thousands)							
Money market funds	\$ 20	\$	\$	\$ 20	\$ 74,118	\$	\$	\$ 74,118
Auction rate securities			104,138	104,138			94,014	94,014
Put option			7,137	7,137			27,465	27,465
Total financial assets	\$ 20	\$	\$ 111,275	\$ 111,295	\$ 74,118	\$	\$ 121,479	\$ 195,597

The tables below present reconciliations for the Company's Level 3 financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended September 27, 2009 and September 28, 2008, respectively.

	Three Months Ended September 27, 2009		Three Months Ended September 28, 2008
	Auction rate securities	Put option	Auction rate securities
	(in thousands)		
Balance, beginning of period	\$ 110,839	\$ 10,811	\$ 108,500
Redemptions at par	(10,375)		
Change in fair value	3,674	(3,674)	(1,600)
Balance, end of period	\$ 104,138	\$ 7,137	\$ 106,900



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	<b>Nine Months Ended September 27, 2009</b>		<b>Nine Months Ended September 28, 2008</b>
	<b>Auction rate securities</b>	<b>Put option (in thousands)</b>	<b>Auction rate securities</b>
Balance, beginning of period	\$ 94,014	\$ 27,465	\$
Transfer in			121,900
Redemptions at par	(10,625)		
Change in fair value	20,749	(20,328)	(15,000)