

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

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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 July 1, 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**

**Sunnyvale, California**

**20-3898239**  
(I.R.S. Employer

Identification No.)

**94088**

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (408) 962-2500

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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 August 9, 2007:

Class	Number of Shares
Class A Common Stock, \$0.001 par value	135,100,010
Class B Common Stock, \$0.001 par value	1
Class C Common Stock, \$0.001 par value	1

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**Table of Contents**

Table of Contents

**INDEX**

	<b>Page No.</b>
Part I. Financial Information	
Item 1. <u>Financial Statements</u>	3
<u>Condensed Consolidated Statements of Operations (Unaudited) - Three and Six Months Ended July 1, 2007 and July 2, 2006</u>	3
<u>Condensed Consolidated Balance Sheets - July 1, 2007 (Unaudited) and December 31, 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) - Six Months Ended July 1, 2007 and July 2, 2006</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	34
Part II. Other Information	
Item 1. <u>Legal Proceedings</u>	35
Item 1A. <u>Risk Factors</u>	36
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	59
Item 6. <u>Exhibits</u>	60
<u>Signature</u>	61

**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>Six Months Ended</b>	
	<b>Jul. 1, 2007</b>	<b>Jul. 2, 2006</b>	<b>Jul. 1, 2007</b>	<b>Jul. 2, 2006</b>
Net sales	\$ 373,710	\$ 396,735	\$ 788,665	\$ 396,735
Net sales to related parties <i>(Note 6)</i>	235,462	258,617	448,278	820,546
<b>Total net sales</b>	<b>609,172</b>	<b>655,352</b>	<b>1,236,943</b>	<b>1,217,281</b>
Operating expenses:				
Cost of sales <i>(including \$63,689, \$55,782, \$104,474 and \$113,323 of expenses charged by related parties)</i>	502,052	523,295	1,040,619	976,285
Research and development <i>(including \$335, \$4,265, \$779 and \$8,677 of expenses charged by related parties)</i>	110,815	90,037	212,661	173,779
Sales, general and administrative <i>(including \$436, \$7,187, \$922 and \$17,457 of expenses charged by related parties)</i>	61,012	69,068	118,801	132,303
<b>Total operating expenses</b>	<b>673,879</b>	<b>682,400</b>	<b>1,372,081</b>	<b>1,282,367</b>
<b>Operating loss</b>	<b>(64,707)</b>	<b>(27,048)</b>	<b>(135,138)</b>	<b>(65,086)</b>
Other income (expense), net:				
Gain on sale of marketable securities		6,884		6,884
Loss on early extinguishment of debt	(3,435)	(17,310)	(3,435)	(17,310)
Interest income and other, net	15,107	4,300	24,038	10,279
Interest expense <i>(including \$0, \$5,281, \$0 and \$11,729 of expenses charged by related parties)</i>	(17,542)	(18,391)	(41,688)	(37,185)
<b>Other income (expense), net</b>	<b>(5,870)</b>	<b>(24,517)</b>	<b>(21,085)</b>	<b>(37,332)</b>
Loss before income taxes	(70,577)	(51,565)	(156,223)	(102,418)
Benefit for income taxes	(3,676)	(2,806)	(13,843)	(1,782)
<b>Net loss</b>	<b>\$ (66,901)</b>	<b>\$ (48,759)</b>	<b>\$ (142,380)</b>	<b>\$ (100,636)</b>
Net loss per common share:				
Basic and diluted	\$ (0.50)	\$ (0.38)	\$ (1.06)	\$ (0.78)

Shares used in per share calculation:

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Basic and diluted

134,827

128,464

134,683

128,311

**See accompanying notes**

3

**Table of Contents****Spansion Inc.****Condensed Consolidated Balance Sheets**

(in thousands)

	Jul. 1, 2007 (Unaudited)	Dec. 31, 2006 (*)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 616,923	\$ 759,794
Marketable securities	100,000	125,975
Trade accounts receivable, net	174,406	199,850
Trade accounts receivable from related parties, net (Note 6)	202,878	193,728
Other receivables from related parties (Note 6)	9,083	2,325
Inventories:		
Raw materials	41,771	44,840
Work-in-progress	317,718	344,603
Finished goods	118,756	66,397
Total inventories	478,245	455,840
Deferred income taxes	34,093	1,395
Prepaid expenses and other current assets	63,748	36,163
Total current assets	1,679,376	1,775,070
Property, plant and equipment, net	2,116,223	1,735,694
Deferred income taxes	17,646	13,556
Other assets	44,556	25,397
Total assets	\$ 3,857,801	\$ 3,549,717
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Notes payable to banks under revolving loans	\$	\$ 33,608
Accounts payable	691,893	408,365
Accounts payable to related parties (Note 6)	53,430	14,559
Accrued compensation and benefits	60,148	51,598
Accrued liabilities to related parties (Note 6)	10,296	11,273
Other accrued liabilities	84,837	59,045
Income taxes payable	25,130	4,333
Deferred income on shipments to a related party	83	229
Deferred income on shipments	36,782	32,267
Current portion of long-term obligations to related parties (Note 8)	500	500
Current portion of long-term debt	8,496	12,560
Current portion of long-term obligations under capital leases	42,442	61,706
Total current liabilities	1,014,037	690,043
Deferred income taxes	67	188
Long-term debt, less current portion	1,063,247	934,138
Long-term obligations under capital leases, less current portion	58,570	75,535
Other long-term liabilities	37,893	4,053

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Commitments and contingencies		
Stockholders' equity	1,683,987	1,845,760
Total liabilities and stockholders' equity	\$ 3,857,801	\$ 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>Six Months Ended</b>	
	<b>Jul. 1,</b>	<b>Jul. 2,</b>
	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (142,380)	\$ (100,636)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	257,252	272,429
Loss on pension curtailment	2,010	
Loss on early extinguishment of debt	3,435	17,310
Provision for doubtful accounts	1,727	(312)
(Benefit) Provision for deferred income taxes	(36,697)	1,463
Net gain on sale and disposal of property, plant and equipment	(14,597)	(465)
Gain on sale of marketable securities		(6,884)
Compensation recognized under employee stock plans	7,341	14,231
Amortization of discount on senior subordinated and senior notes	1,198	1,960
Changes in operating assets and liabilities:		
(Increase) Decrease in trade accounts receivable from related parties	(9,805)	159,262
(Increase) Decrease in other receivables from related parties	(6,758)	12,207
Decrease (Increase) in trade accounts receivable	24,371	(195,624)
Increase in inventories	(22,864)	(25,925)
Increase in prepaid expenses and other current assets	(27,136)	(14,995)
(Increase) Decrease in other assets	(22,594)	189
Increase (Decrease) in accounts payable and accrued liabilities to related parties	37,894	(102,715)
Increase in accounts payable and accrued liabilities	289,896	66,043
Decrease in accrued compensation and benefits	(2,334)	(9,992)
Increase (Decrease) in income taxes payable	20,746	(10,301)
Decrease in deferred income on shipments to a related party	(146)	(31,492)
Increase in deferred income on shipments	4,514	27,306
Net cash provided by operating activities	365,073	73,059
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sale of property, plant and equipment	186,226	2,298
Purchases of property, plant and equipment	(769,889)	(290,940)
Proceeds from maturity and sale of marketable securities	633,050	272,721
Purchases of marketable securities	(607,075)	(63,612)
Net cash used in investing activities	(557,688)	(79,533)
<b>Cash Flows from Financing Activities:</b>		
Cash distribution to related parties for stock-based compensation		(5,991)
Proceeds from borrowings, net of issuance costs	625,844	320,373
Proceeds from issuance of stock	60	
Payments on loans from related parties		(196,619)
Payments on debt and capital lease obligations	(570,952)	(280,004)



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Net cash provided by (used in) financing activities	54,952	(162,241)
Effect of exchange rate changes on cash and cash equivalents	(5,208)	16,807
Net decrease in cash and cash equivalents	(142,871)	(151,908)
Cash and cash equivalents at the beginning of period	759,794	506,439
Cash and cash equivalents at end of period	\$ 616,923	\$ 354,531

**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 to 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 July 1, 2007 and July 2, 2006 consisted of 13 weeks and 14 weeks, respectively. The six months ended July 1, 2007 and July 2, 2006 consisted of 26 weeks and 27 weeks, respectively. The second quarter of fiscal 2006 consisted of one week more than the same quarter of fiscal 2007.

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**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. Actual results may differ from those estimates, and such differences may be material to the financial statements.

**Financial Statements 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 effect of this adoption resulted in an increase to the Company's accumulated deficit of approximately \$10 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 six months ended July 1, 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 vested or accreted 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 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 and six months ended July

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**Table of Contents**

**Spansion Inc.**

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

**(Unaudited)**

1, 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 July 1, 2007, the Company's total gross unrecognized tax benefits were \$3.1 million of which \$2.3 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 six months ended July 1, 2007 was primarily due to tax positions taken during a prior period.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expenses.

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.

Interest and penalties incurred in the six months ended July 1, 2007 were immaterial.

**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 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 restricted stock unit awards then outstanding under the 2005 Plan.

The 2007 Plan provides awards that may be granted to an officer or employee, a consultant or advisor, or a non-employee director of the Company or its subsidiaries. Stock options and restricted stock unit awards issued under the 2007 Plan generally vest 25 percent after one year, and the balance ratably over a period of four years and expire if not exercised by the seventh anniversary of the grant date. Restricted stock unit awards have no exercise price or expiration date. Restricted stock unit awards issued under the 2007 Plan generally vest over a four year period.

**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 May 29, 2007, net of cancelled stock options	(3,505,718)
Restricted stock unit awards granted through May 29, 2007, net of cancelled restricted stock unit awards	(5,041,842)
Shares transferred to the 2007 Plan	(920,523)
Ungranted shares under the 2005 Plan <sup>(1)</sup>	31,917
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 July 1, 2007, net of cancelled stock options	(62,500)
Restricted stock unit awards granted through July 1, 2007, net of cancelled restricted stock unit awards	(98,370)
Shares available for grant under the 2007 Plan	7,434,653

<sup>(1)</sup> The remaining ungranted shares under the 2005 Plan were related to stock options or restricted stock unit 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 of 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 six months ended July 1, 2007 and July 2, 2006:

	Three Months Ended		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
	(in thousands)			
Cost of sales	\$ 2,174	\$ 2,139	\$ 3,671	\$ 5,254
Research and development	1,086	1,070	1,835	2,629
Sales, general and administrative	1,086	1,070	1,835	2,629
Stock-based compensation expense before income taxes	4,346	4,279	7,341	10,512
Income tax benefit <sup>(1)</sup>				

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Stock-based compensation expense after income taxes <sup>(1)</sup>	\$ 4,346	\$ 4,279	\$ 7,341	\$ 10,512
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<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.

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

The weighted average fair value of the Company's stock options granted in the three months ended July 1, 2007 and July 2, 2006 was \$4.85 and \$7.48 per share, respectively. The weighted average fair value of the Company's stock options granted in the six months ended July 1, 2007 and July 2, 2006, was \$4.91 and \$7.84 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 six months ended July 1, 2007 and July 2, 2006:

	Three Months Ended		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
Expected volatility	48.70%	55.92%	48.80%	59.97%
Risk-free interest rate	4.80%	5.10%	4.78%	4.89%
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 lack of 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 July 1, 2007, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately \$55.8 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2010.

**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	1,623,312	\$ 10.56		
Cancelled	(190,000)	\$ 13.62		
Exercised	(5,000)	\$ 12.00		
Outstanding as of July 1, 2007	3,563,218	\$ 11.64	6.11	\$

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Exercisable as of July 1, 2007 <sup>(2)</sup>	583,148	\$	12.20	5.47	\$
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- <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> There were 583,148 shares vested and exercisable as of July 1, 2007, with a total grant date fair value of approximately \$7.1 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 \$11.10 as of June 29, 2007, which was the last trading day prior to July 1, 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	1,536,477	\$ 10.59
Cancelled	(145,768)	\$ 12.40
Vested	(674,987)	\$ 12.10
Unvested as of July 1, 2007	3,639,337	\$ 11.64

<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 19.0 million shares issuable upon exercise of outstanding stock options, upon vesting of outstanding restricted stock units 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 six months ended July 1, 2007 because they had an antidilutive effect due to the net losses recorded in those periods.

The Company excluded 16.8 million shares issuable upon exercise of outstanding stock options and upon vesting of outstanding restricted stock units from the calculation of diluted earnings per share for the three and six months ended July 2, 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		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
	(in thousands)			
Net loss	\$ (66,901)	\$ (48,759)	\$ (142,380)	\$ (100,636)
Amortization of prior service cost	16		194	
Pension curtailment loss	2,010		2,010	
Net change in cumulative translation adjustment	(26,439)	19,611	(19,459)	17,817
Net change in unrealized gains on marketable securities, net of \$0 taxes		(6,230)		(7,291)
Total comprehensive loss	\$ (91,314)	\$ (35,378)	\$ (159,635)	\$ (90,110)

**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 days 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		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
	(in thousands)			
Net sales to AMD <sup>(1)</sup>	\$	\$	\$	336,172
Cost of sales:				
Royalties to AMD	\$ 794	\$ 1,659	\$ 1,555	3,098
Service fees to AMD <sup>(2)</sup> :				
Cost of sales	\$ (513)	\$ (252)	\$ (1,115)	\$ 2,719
Research and development	104	3,651	179	7,289
Sales, general and administrative	105	6,013	214	15,158
Total service fees to AMD	\$ (304)	\$ 9,412	\$ (722)	\$ 25,166

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- (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)**

	<b>Jul. 1, 2007</b>	<b>Dec. 31, 2006</b>
	<b>(in thousands)</b>	
Trade accounts receivable from AMD, net of allowance for doubtful accounts	\$ 2,863	\$ 3,400
Other receivables from AMD	\$ 4,492	\$ 2,325
Accounts payable to AMD	\$ 3,755	\$ 1,513
Royalties payable to AMD	\$ 4,684	\$ 3,130
Accrued liabilities to AMD	\$ 38	\$ 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):

	Three Months Ended		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
	(in thousands)			
Net sales to Fujitsu	\$ 235,462	\$ 258,617	\$ 448,278	\$ 484,374
Cost of sales:				
Royalties to Fujitsu	\$ 794	\$ 1,659	\$ 1,555	\$ 3,098
Other purchases of goods and services from Fujitsu and rental expense to Fujitsu	16,420	30,734	43,901	59,779
Subcontract manufacturing and commercial die purchases from Fujitsu	2,829	21,404	14,877	43,427
Wafer purchases, processing and sort services from Fujitsu <sup>(1)</sup>	58,962		58,962	
Net gain recognized on sale of assets to Fujitsu on April 2, 2007 <sup>(1)</sup>	(9,567)		(9,567)	
Reimbursement on costs of employees seconded to Fujitsu <sup>(1)</sup>	(5,968)		(5,968)	
Pension curtailment loss <sup>(1)</sup>	2,010		2,010	
Equipment rental income from Fujitsu <sup>(1)</sup>	(2,030)		(2,030)	
Administrative services income from Fujitsu <sup>(1)</sup>	(290)		(290)	
	\$ 63,160	\$ 53,797	\$ 103,450	\$ 106,304
Service fees to Fujitsu:				
Cost of sales	\$ 248	\$ 561	\$ 583	\$ 1,176
Research and development	231	578	600	1,326
Sales, general and administrative	331	1,113	708	2,205
Service fees to Fujitsu	\$ 810	\$ 2,252	\$ 1,891	\$ 4,707
Cost of employees seconded from Fujitsu:				
Cost of sales	\$	\$ 18	\$	\$ 26
Research and development		35		61
Sales, general and administrative		61		95
Cost of employees seconded from Fujitsu	\$	\$ 114	\$	\$ 182

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

	Jul. 1, 2007	Dec. 31, 2006
	(in thousands)	
Trade accounts receivable from Fujitsu	\$ 200,015	\$ 190,328
Other receivables from Fujitsu	\$ 4,591	\$
Accounts payable to Fujitsu	\$ 49,675	\$ 13,046
Royalties payable to Fujitsu	\$ 1,554	\$ 3,130

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Accrued liabilities to Fujitsu	\$ 4,020	\$ 4,970
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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.

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**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 its 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 who 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 and Fujitsu to supply 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 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 six months ended July 1, 2007 and July 2, 2006 are as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>Jul. 1, 2007</b>	<b>Jul. 2, 2006</b>	<b>Jul. 1, 2007</b>	<b>Jul. 2, 2006</b>
	(in thousands)			
Balance, beginning of period	\$ 1,350	\$ 1,000	\$ 1,350	\$ 1,000
Provision for warranties issued	1,220	876	2,484	1,684
Settlements	(973)	(324)	(1,108)	(2,242)
Changes in liability for pre-existing warranties during the period, including expirations	3	(552)	(1,126)	558
Balance, end of period	\$ 1,600	\$ 1,000	\$ 1,600	\$ 1,000

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:

	Jul. 1, 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	229,429	228,231
Spansion Japan 2006 Revolving Credit Facility		8,402
Spansion Penang Loan	2,645	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
Senior Secured Floating Rate Notes	625,844	
Obligations under capital leases	101,012	137,240
<b>Total debt obligations to third parties</b>	<b>1,172,755</b>	<b>1,117,547</b>
<b>Total debt obligations</b>	<b>1,173,255</b>	<b>1,118,047</b>
Less current portion	51,438	108,374
<b>Long-term debt and capital lease obligations, less current portion</b>	<b>\$ 1,121,817</b>	<b>\$ 1,009,673</b>

**New Debt and Capital Lease Obligations and Activities for the six months ended July 1, 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 2007 Credit Facility***

On March 30, 2007, Spansion Japan entered into a senior facility agreement with certain Japanese financial institutions that provide Spansion Japan with a 48.4 billion yen senior secured term loan facility (approximately \$392.9 million as of July 1, 2007).

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Spansion Japan may, pursuant to the terms of this facility, borrow amounts in increments of 1.0 billion yen (approximately \$8.1 million as of July 1, 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 2 percent per annum.

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;

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**Table of Contents**

**Spansion Inc.**

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

**(Unaudited)**

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 July 1, 2007, no amounts were outstanding under this credit facility.

***Spansion Japan 2006 Merged 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 July 1, 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 July 1, 2007.

***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 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 debt issuance costs.

***Senior Secured Floating Rate Notes***

In May 2007, Spansion LLC, the wholly owned operating company subsidiary of the Company, issued \$625 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.

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 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

**Table of Contents**

**Spansion Inc.**

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

**(Unaudited)**

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 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 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.

**9. Income Taxes**

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The Company recorded an income tax benefit of \$3.7 million in the three months ended July 1, 2007 as compared to \$2.8 million of tax benefits in the three months ended July 2, 2006. The income tax benefit recorded in the three months ended July 1, 2007 was primarily due to a decrease in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary, in part due to the gain recognized on the sale of JV1/JV2, offset by tax provisions of its foreign subsidiaries. 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 July 1, 2007 represents the portion of the deferred tax assets that will be recognized in the current year as part of the

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

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 benefit recorded in the three months ended July 2, 2006 was primarily due to a benefit from resolution of a tax examination in a foreign jurisdiction, offset by tax provisions of its foreign subsidiaries.

The Company recorded an income tax benefit of \$13.8 million in the six months ended July 1, 2007 as compared to \$1.8 million of tax benefits in the six months ended July 2, 2006. The income tax benefit recorded in the six months ended July 1, 2007 was primarily due to the decrease in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary recorded in the first quarter of fiscal 2007 because the Company believes that it is more likely than not that these deferred tax assets will be realized, offset by tax provisions 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 six months ended July 1, 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 benefit recorded in the six months ended July 2, 2006 was primarily related to a resolution of a tax examination in a foreign jurisdiction, offset by tax provisions of its foreign subsidiaries.

As of July 1, 2007, most 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 July 1, 2007, in management's estimate, is not more likely than not to be achieved.

**10. Spansion Japan Pension Plan**

On September 1, 2005, the Company adopted the Spansion Japan pension plan. The following table summarizes the components of the net periodic pension expense for the three and six months ended July 1, 2007 and July 2, 2006:

	Three Months Ended		Six Months Ended	
	Jul. 1, 2007	Jul. 2, 2006	Jul. 1, 2007	Jul. 2, 2006
	(in thousands)			
Service cost	\$ 1,311	\$ 1,389	\$ 2,637	\$ 2,576
Interest cost	393	488	791	765
Expected return on plan assets	(859)	(718)	(1,729)	(1,415)
Amortization of prior service cost	2,026	189	2,205	372
<b>Total net periodic pension expense</b>	<b>\$ 2,871</b>	<b>\$ 1,348</b>	<b>\$ 3,904</b>	<b>\$ 2,298</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).



**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 the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act). 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. On April 2, 2007, we completed the sale of two wafer fabrication facilities located in Aizu-Wakamatsu, Japan to Fujitsu Limited. We currently operate two Flash memory 200-millimeter wafer fabrication facilities and have begun producing 300mm 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 July 1, 2007 and July 2, 2006 were \$609.2 million and \$655.4 million, respectively. The decrease in the 2007 period compared to the 2006 period was due primarily to a decrease in average selling prices, while unit shipments were relatively flat. Our MirrorBit technology represented approximately 69 percent of total net sales for the three months ended July 1, 2007, compared with approximately 43 percent of total sales for the corresponding period of fiscal 2006.

Our total net sales for the six months ended July 1, 2007 and July 2, 2006 were each approximately \$1.2 billion. Our MirrorBit technology represented approximately 68 percent of total net sales and 40 percent of total units shipped for the six months ended July 1, 2007, compared with approximately 39 percent of total sales and 24 percent of total units shipped for the corresponding period of fiscal 2006.

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## **Table of Contents**

Our net losses for the three and six months ended July 1, 2007 were \$66.9 million and \$142.4 million, respectively. The benefit for income taxes included in our net losses for the three and six months ended July 1, 2007 was \$3.7 million and \$13.8 million, respectively.

Our net losses for the three and six months ended July 2, 2006 were \$48.8 million and \$100.6 million, respectively. The benefit for income taxes included in our net losses for the three and six months ended July 2, 2006 was \$2.8 million and \$1.8 million, respectively.

Our cash and cash equivalents at July 1, 2007, totaled \$616.9 million and consisted of cash, money market funds and commercial paper. During the six months ended July 1, 2007, we obtained cash proceeds of \$625.8 million from the issuance of Senior Secured Floating Rate Notes, net of issuance costs, of which \$571.0 million was used for payments on debt and capital lease obligations, \$500.0 million of which constituted repayment of the Senior Secured Term Loan Facility. We believe that our anticipated cash flows from operations and current cash balances, our existing credit facilities and available external financing 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 July 1, 2007 and July 2, 2006 consisted of 13 weeks and 14 weeks, respectively. The six months ended July 1, 2007 and July 2, 2006 consisted of 26 weeks and 27 weeks, respectively. The second quarter of fiscal 2006 consisted of one week more than the same quarter of fiscal 2007.

### **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.

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 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

**Table of Contents**

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 the Company's 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 six months ended July 1, 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 vested or accreted to the employee until completion of the full seven years of service. With the adoption of EITF 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 six months ended July 1, 2007 and July 2, 2006:

	Three Months Ended				Jul. 1, 2007	Six Months Ended			
	Jul. 1, 2007	Jul. 2, 2006	Variance in Dollars	Variance in Percent		Jul. 2, 2006	Variance in Dollars	Variance in Percent	
	(in thousands, except percentage)					(in thousands, except percentage)			
Total net sales	\$ 609,172	\$ 655,352	\$ (46,180)	-7%	\$ 1,236,943	\$ 1,217,281	\$ 19,662	2%	

Total net sales for the three months ended July 1, 2007 decreased seven percent compared to total net sales for the three months ended July 2, 2006. The decrease was primarily attributable to a seven percent decrease in average selling prices. Unit shipments for the three months ended July 1, 2007 as compared to the three months ended July 2, 2006 were relatively flat. Total net sales for the six months ended July 1, 2007 increased two percent compared to total net sales for the six months ended July 2, 2006. The increase was primarily attributable to a three percent increase in unit shipments, partially offset by a one percent decrease in average selling prices. Our MirrorBit products represented approximately 69 percent and 68 percent of total net sales for the three and six months ended July 1, 2007 as compared to approximately 43 percent and 39 percent of total net sales for the three and six months ended July 2, 2006. Net sales to the wireless sector and net sales to the consumer, industrial and automotive sectors, were approximately \$337.5 million and \$271.5 million, respectively, for the three months ended July 1, 2007.

**Table of Contents****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 benefit for income taxes for the three and six months ended July 1, 2007 and July 2, 2006:

	Three Months Ended				Six Months Ended			
	Jul. 1, 2007	Jul. 2, 2006	Variance in Dollars	Variance in Percent	Jul. 1, 2007	Jul. 2, 2006	Variance in Dollars	Variance in Percent
	(in thousands, except for percentage)				(in thousands, except for percentage)			
Cost of sales	502,052	523,295	(21,243)	-4%	1,040,619	976,285	64,334	7%
Gross margin	18%	20%			16%	20%		
Research and development	110,815	90,037	20,778	23%	212,661	173,779	38,882	22%
Sales, general and administrative	61,012	69,068	(8,056)	-12%	118,801	132,303	(13,502)	-10%
Operating loss	(64,707)	(27,048)	(37,659)	139%	(135,138)	(65,086)	(70,052)	108%
Interest income and other income (expense), net	11,672	(6,126)	17,798	-291%	20,603	(147)	20,750	-14116%
Interest expense	(17,542)	(18,391)	849	-5%	(41,688)	(37,185)	(4,503)	12%
Benefit for income taxes	(3,676)	(2,806)	(870)	31%	(13,843)	(1,782)	(12,061)	677%

The decrease in gross margin for the three and six months ended July 1, 2007 was primarily due to the per bit decline in average selling prices as a result of the intense competitive environment in the industry. This decline in average selling prices was partially offset by a significant reduction in the cost per bit on a year-over-year basis. Gross margin in the second quarter of fiscal 2007 included a portion of the gain (approximately \$7.0 million) recognized from the JV1/JV2 Transaction. The total gain from the JV1/JV2 Transaction will be recognized over the term of the Foundry Agreement with Fujitsu.

The increase in research and development expense for the three and six months ended July 1, 2007 was primarily due to an increase in 300-millimeter development costs in our Flash memory manufacturing facility in Aizu-Wakamatsu, Japan, which we refer to as SP1, and the SDC, which together represented approximately 71 percent and 64 percent of the increase for the three and six months ended July 1, 2007, respectively. Also, we incurred higher labor costs, consulting expenses and engineering project spending during the three and six months ended July 1, 2007. The increase was partially offset by lower research and development expenses in other manufacturing facilities in Austin, Texas and Aizu-Wakamatsu, Japan. The decrease in research and development expenses in Japan was primarily due to the sale of our JV1/JV2 facilities.

The decrease in sales, general and administrative expense for the three and six months ended July 1, 2007 was primarily due to lower information technology, legal and consulting fees. Approximately 62 percent and 69 percent of the decrease for the three and six months ended July 1, 2007, was a result of the reduction in services provided by AMD, which was partially offset by increased headcount costs in information technology, sales and other administrative organizations. Since fiscal 2006, we have expanded our administrative functions and significantly reduced our reliance on administrative services provided by AMD. Additionally, we incurred lower consulting and outside service expenses for the three and six months ended July 1, 2007. The decrease was partially offset by higher depreciation and communication expenses for the three and six months ended July 1, 2007.

The increase in interest income and other income, net of other expenses for the three and six months ended July 1, 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 \$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 was also partly 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.

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**Table of Contents**

Interest income has increased due to the combined effect of increases in the company's invested cash, cash equivalents and marketable securities balances, and the increase in the company's average investment portfolio yield of approximately 0.5 percent and 0.7 percent for the three and six months ended July 1, 2007, respectively.

The decrease in interest expense for the three months ended July 1, 2007 as compared to the corresponding period of fiscal 2006 resulted primarily from a decrease of approximately \$8.2 million in the interest expense related to an adjustment to a capital lease during the second quarter of fiscal 2007. Excluding the \$8.2 million adjustment, the interest expense increased by approximately \$7.4 million and \$12.7 million for the three and six months ended July 1, 2007, respectively. The increases were primarily due to the higher average debt balances for the three and six months ended July 1, 2007 as compared to the same periods of fiscal 2006. 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. However, the increase in interest expense was partially offset by a lower average interest rate on the debt portfolio for the three and six months ended July 1, 2007 as compared to the same periods of fiscal 2006. The average interest rates were 7.6 percent and 7.5 percent for the three and six months ended July 1, 2007 as compared to 9.0 percent and 8.9 percent for three and six months ended July 2, 2006.

We recorded an income tax benefit of \$3.7 million in the three months ended July 1, 2007 as compared to \$2.8 million of tax benefits in the three months ended July 2, 2006. The income tax benefit recorded in the three months ended July 1, 2007 was primarily due to a decrease in the valuation allowance associated with deferred tax assets of our Japanese subsidiary, in part due to the gain recognized on the sale of JV1/JV2, offset by tax provisions of our foreign subsidiaries. This decrease of 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 July 1, 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 of 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 benefit recorded in the three months ended July 2, 2006 was primarily due to a benefit from resolution of a tax examination in a foreign jurisdiction, offset by tax provisions of our foreign subsidiaries.

We recorded an income tax benefit of \$13.8 million in the six months ended July 1, 2007 as compared to \$1.8 million of tax benefits in the six months ended July 2, 2006. The income tax benefit recorded in the six months ended July 1, 2007 was primarily due to the decrease in the valuation allowance associated with deferred tax assets of our Japanese subsidiary, recorded in the first quarter of fiscal 2007 because we believe that it is more likely than not that these deferred tax assets will be realized, offset by tax provisions of our foreign subsidiaries. During the first quarter of fiscal 2007, the Company 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 six months ended July 1, 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 benefit recorded in the six months ended July 2, 2006 was primarily related to a resolution of a tax examination in a foreign jurisdiction, offset by tax provisions of our foreign subsidiaries.

As of July 1, 2007 most 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 July 1, 2007, in management's estimate, is not more likely than not to be achieved.

**Table of Contents****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 July 1, 2007, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately \$55.8 million after reduction for estimated forfeitures. Such stock options and RSU awards will generally vest ratably through 2010.

**Contractual Obligations**

The following table summarizes our contractual obligations as of July 1, 2007.

	Total	2007	2008	2009 (in thousands)	2010	2011	2012 and Beyond
<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
Capital lease obligations	90,539	15,004	34,614	25,616	8,774	6,530	
Credit Facility - Subsidiaries	9,470	4,916	4,276	278			
<b>Total principal contractual obligations</b>	<b>1,182,509</b>	<b>20,420</b>	<b>38,890</b>	<b>25,894</b>	<b>8,774</b>	<b>6,530</b>	<b>1,082,000</b>
Operating leases	21,278	8,127	8,357	2,038	1,410	345	1,001
Unconditional purchase commitments	663,481	199,822	274,333	161,820	23,858	3,648	
Interest payments on debt and capital leases	634,853	47,572	91,437	90,331	87,722	87,002	230,789
<b>Total contractual obligations</b>	<b>\$ 2,502,121</b>	<b>\$ 275,941</b>	<b>\$ 413,017</b>	<b>\$ 280,083</b>	<b>\$ 121,764</b>	<b>\$ 97,525</b>	<b>\$ 1,313,790</b>

**Spansion Japan 2007 Credit Facility**

In March 2007, Spansion Japan entered into a senior facility agreement with certain Japanese financial institutions that provide Spansion Japan with a 48.4 billion yen senior secured term loan facility (approximately \$392.9 million as of July 1, 2007).

Spansion Japan may, pursuant to the terms of this facility, borrow amounts in increments of 1.0 billion yen (approximately \$8.1 million as of July 1, 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 2 percent per annum.

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 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.

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**Table of Contents**

As of July 1, 2007, no amounts were outstanding under the Spansion Japan 2007 Credit Facility.

***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. 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.

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 million (or its foreign equivalent at the time);

## **Table of Contents**

If any judgment or judgments for the payment of money in an aggregate amount in excess of \$50 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.

## **Other Financial Matters**

### ***JV1/JV2 Transaction***

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 (the JV1/JV2 Facilities ), to Fujitsu together with its 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 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 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 Transaction and the related agreements that Spansion Japan entered into with Fujitsu.

### ***Liquidity and Capital Resources***

Our cash and cash equivalents at July 1, 2007, totaled \$616.9 million and consisted of cash, money market funds and commercial paper. 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, 2007 filed with the Securities and Exchange Commission on February 27, 2007.



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**Table of Contents*****Net Cash Provided by (Used in) Operating Activities***

Net cash provided by operating activities was \$365.1 million in the six months ended July 1, 2007. Non-cash charges included in the net loss consisted primarily of \$257.3 million of depreciation, benefit for deferred income taxes of \$36.7 million and compensation cost recognized under stock plans of \$7.3 million. The net changes in operating assets and liabilities in the six months ended July 1, 2007 were primarily attributable to an increase in inventory of \$22.9 million, an increase in prepaid expenses and other current asset of \$27.1 million, an increase in other asset of \$22.6 million, an increase in accounts payable and accrued liabilities of \$327.8 million and an increase in income taxes payable of \$20.7 million. We have increased our inventory balance, principally in finished goods, at the end of the second quarter of fiscal 2007 to meet the anticipated increased seasonal demand in the second half of the year. The increase in accounts payable and accrued liabilities was primarily due to our capital expenditures for SP1, which will be paid over the next two quarters. The increase in income taxes payable was primarily due to the gain from JV1/JV2 Transaction in the second quarter of fiscal 2007. We expect cash provided by operating activities to decrease in each of the next two fiscal quarters as we settle our accounts payable and accrued liabilities related to capital expenditures for SP1.

Net cash provided by operating activities was \$73.1 million in the six months ended July 2, 2006. Non-cash charges included in the net loss consisted primarily of \$272.4 million of depreciation and amortization, loss on debt extinguishment of \$17.3 million and compensation cost recognized under stock plans of \$14.2 million. The net changes in operating assets in the six months ended July 2, 2006 were primarily attributable to a decrease in accounts payable and accrued liabilities of \$36.7 million, an increase in accounts receivable of \$24.2 million, and an increase in inventories of \$25.9 million compared to December 25, 2005.

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

Net cash used in investing activities was \$557.7 million in the six months ended July 1, 2007, of which \$769.9 million related to acquisition of property, plant and equipment, in particular at our 300-millimeter development and technology facilities, SP1 and SDC, offset in part by a cash inflow of \$186.2 million from sale of property, plant and equipment, mainly from JV1/JV2 Transaction, and a net cash inflow of \$26.0 million from the maturity and sale of marketable securities (\$633.1 million from the maturity and sale of, offset by a cash outflow of \$607.1 million for the purchase of, marketable securities).

Net cash used in investing activities was \$79.5 million in the six months ended July 2, 2006, primarily as a result of \$290.9 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 \$272.7 million from the maturity and sale of marketable securities.

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

Net cash used in financing activities was \$55.0 million in the six months ended July 1, 2007, primarily as a result of \$625.8 million of proceeds from issuance of Senior Secured Floating Rate Notes, net of issuance costs, offset in part by \$571.0 million in payments on debt and capital lease obligations, \$500.0 million of which constituted repayment of the Senior Secured Term Loan Facility.

Net cash used in financing activities was \$162.2 million in the six months ended July 2, 2006. This amount included \$476.6 million in payments on debt and capital lease obligations, including \$196.6 million in payments to AMD, of which \$175.0 million was used to repurchase the 12.75% Senior Subordinated Notes, and \$6.0 million in payments to AMD for stock-based compensation, offset in part by a cash inflow of \$320.4 million of proceeds from borrowings, net of issuance costs, of which approximately \$207.0 million was from the issuance of 2.25% Exchangeable Senior Subordinated Debentures.

## **Table of Contents**

Our future uses of cash will primarily be for working capital, capital expenditures, debt service and other contractual obligations. Our capital expenditures during the six months ended July 1, 2007 were \$769.9 million, and we expect to spend approximately \$230.0 million on capital expenditures during the remainder of fiscal 2007.

The total amount due on debt service and other contractual obligations during the remainder of fiscal 2007 is approximately \$275.9 million. We have \$207.0 million in outstanding 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 July 1, 2007.

As of July 1, 2007, we have cash and cash equivalents of \$616.9 million, marketable securities of \$100.0 million and \$260.5 million available under our credit facilities, totaling \$977.4 million.

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

We believe that our anticipated cash flows from operations and current cash balances, our existing credit facilities and available external financing 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.

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**Table of Contents**

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

At the July 25, 2007 Financial Accounting Standards Board ( FASB ) meeting, the FASB Board 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 would address instruments commonly referred as Instrument C from Emerging Issues Task Force ( EITF ) Issue No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion (EITF 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.

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 we believe the Exchangeable Debt would fall under the description of Instrument C under EITF 90-19. 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 application) 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 six months of fiscal 2007 except as follows: during the first six 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.

**Table of Contents**

**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 second quarter of fiscal 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

***Tessera, Inc. v. Advanced Micro Devices, Inc. and 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 and AMD 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, ST Microelectronics and AMD filed a motion to stay the District Court action pending resolution of the proceeding before the International Trade Commission described below.

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.

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

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**Table of Contents**

***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.

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

**ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk. 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 half 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

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**Table of Contents**

will represent approximately 75 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 half 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 half 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 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 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.

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**Table of Contents**

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.

***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 in China.

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 half of fiscal 2007 our business was adversely affected by a greater than average seasonal decline in price per bit selling prices as a result of intense competitive pressures. 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.



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**Table of Contents**

*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 million, \$304 million and \$20 million, respectively, and in the first half of fiscal 2007 we incurred a net loss of approximately \$142 million. As a result, we continue to undertake actions in an effort to significantly reduce our expenses, including our goal to reduce \$50-100 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.

*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 ten 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 a two and a half 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. 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

## **Table of Contents**

NOR-based products, which would adversely affect us. We believe such downward pricing pressure was a factor in the steep declines in price-per-bit 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.

***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.

***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.

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

Sales of our products are dependent to a large extent on demand for mobile phones. Historically, a small number of wireless Flash memory customers have driven a substantial portion of our net sales. If one of these customers decided to stop buying our Flash memory products, or if one of these customers were materially to reduce its operations or 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 demand by certain customers for our custom high density NOR-based Flash memory solutions used in mid-range wireless handsets. Similar reductions in demand could materially adversely affect our future revenues.

**Table of Contents**

***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. At the time of our IPO, our aggregate principal amount of outstanding debt was approximately \$760 million. As of July 1, 2007, we had an aggregate principal amount of approximately \$1.2 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 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 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;

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 million, provided, however, that investments are limited to no more than a total of \$50 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;

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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 million.

## **Table of Contents**

In addition, the indentures governing Spansion LLC's \$250 million principal amount of 11.25% Senior Notes due 2016 and Spansion LLC's \$625 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 July 1, 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. For example, as of December 25, 2005, Spansion Japan was not in compliance with certain financial covenants under its debt instruments but obtained waivers from the other parties. Also, we obtained an amendment to the Credit Agreement to our Senior Secured Term Loan Facility, which provides changes to certain financial 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. 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 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. Any equity financing would cause 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.

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**Table of Contents**

***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.

***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 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. We began delivering a version of this product in the first quarter of fiscal 2005, and we began delivering our new, higher performance version of the product by the end of the second quarter of fiscal 2005.

***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

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**Table of Contents**

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, due to our recent sale of our JV1/JV2 manufacturing facilities, we now obtain foundry services from Fujitsu. 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.

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 cyclicality in the Flash memory market, which may in the future negatively impact our average selling prices and materially adversely affect us.

## **Table of Contents**

### ***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 historical financial results may not be indicative of our future performance.***

Our historical financial information does not necessarily indicate what our results of operations, financial condition or cash flows will be in the future. After our reorganization as Spansion LLC and prior to our initial public offering, we were a majority-owned subsidiary of AMD, and we sold all of our products to our sole distributors, AMD and Fujitsu, who in turn sold our products to customers worldwide. Upon our initial public offering, we became an independent company. Since that time, we have transitioned our sales processes so that we are able to sell our products directly to AMD's former customers and customers not served solely by Fujitsu. We have also expanded our administrative functions and reduced our reliance on AMD's provision of administrative services. Because of these significant changes, our historical financial results may not be indicative of our future financial results.

### ***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 the recently 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 in order to increase market share, which resulted in decreased average selling prices for our products in the second half of fiscal 2004 and the first quarter of fiscal 2005 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



## **Table of Contents**

NOR businesses or other NAND businesses, or if our competitors otherwise consolidate their operations. For example, Intel Corporation and STMicroelectronics recently 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 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.

*If we are unable to diversify our customer base, we could be materially adversely affected.*

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 half of fiscal 2007, the five largest of these customers accounted for a significant portion of end sales of our products. 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. 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 used in mid-range wireless handsets.

*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 half of fiscal 2007, our research and development expenses were approximately \$342 million and \$213 million, respectively, or approximately 13 and 17 percent 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.

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**Table of Contents**

*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 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.

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**Table of Contents**

***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, 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.

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**Table of Contents**

***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. Implementation of information systems is particularly difficult since our systems have historically been integrated into AMD's systems. Implementation has also required significant upgrades and enhancements to our existing computer hardware and software systems. Historically, other companies have experienced substantial delays in the implementation of such information systems. Implementation of these information systems is complex, expensive and time consuming and successful implementation could be delayed or otherwise adversely affected by various factors including:

any failure to provide adequate training to employees;

any failure to retain key members of the implementation team or to find suitable replacements for such personnel;

any failure to develop and apply appropriate testing procedures that accurately reflect the demands that will be placed on these information systems following implementation; and

any failure to develop and implement adequate back-up systems and procedures in the event that difficulties or delays arise during or following the implementation of these information systems.

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 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

## **Table of Contents**

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.

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.

## **Table of Contents**

### ***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 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;



**Table of Contents**

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.

***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.





## **Table of Contents**

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.

***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.

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**Table of Contents**

*The interests of AMD and Fujitsu, and our directors nominated by them, 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.

AMD and Fujitsu are two of our largest stockholders. AMD has the right to elect one member to our board of directors. Fujitsu also has the right to elect one member to our board of directors, although Fujitsu currently does not have a representative on 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 ten percent.

In addition, the director appointed by AMD continues to hold his position at AMD. Individuals who are our directors and also officers of either AMD or 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 AMD or 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 AMD or Fujitsu acquires knowledge of a potential business opportunity that may be deemed a corporate opportunity of our company and AMD or Fujitsu, such opportunity will belong to AMD or 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, or stock options to acquire AMD common stock by any of our directors and 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

**Table of Contents**

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.

***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 half 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.

Because we are dependent upon Fujitsu as the sole distributor of our products to customers in Japan, we do not currently maintain a local sales organization, have local sales infrastructure, or have direct customer relationships and an established brand identity. 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. If this occurs, sales to customers served by Fujitsu 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. AMD may grant licenses under our patents, provided that these licenses are of no broader scope than, and are subject to the same terms and conditions that apply to, any license of AMD's patents granted in connection with such license, and the recipient of such license grants to us a license of similar scope under its patents.

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

**Table of Contents**

(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.

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**Table of Contents**

***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.

***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 \$227 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.

**Table of Contents**

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

Our 2007 Annual Meeting of Stockholders was held on May 29, 2007 in East Palo Alto, California. Of the 134,674,603 shares of Class A common stock, 1 share of Class B common stock and 1 share of Class C common stock outstanding as of the record date, 93 percent of Class A common stock, and 100 percent of each of Class B and Class C common stock were present or represented by proxy at the meeting. The results of the voting on the matters submitted to the stockholders are as follows:

1. To elect two Class A directors to serve until the 2010 Annual Meeting of Stockholders or until their successor is duly elected and qualified.

<b>Name</b>	<b>Votes For</b>	<b>Votes Withheld</b>
Patti S. Hart	124,003,866	990,562
John M. Stich	124,003,103	991,325

2. To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the current fiscal year.

<b>Votes For</b>	<b>Votes Against</b>	<b>Votes Abstaining</b>	<b>Broker Non-Vote</b>
124,067,376	19,889	907,165	0

3. To approve the Spansion Inc. 2007 Equity Incentive Plan.

<b>Votes For</b>	<b>Votes Against</b>	<b>Votes Abstaining</b>	<b>Broker Non-Vote</b>
103,979,019	10,130,687	899,743	9,984,981



**Table of Contents**

**ITEM 6. EXHIBITS**

- 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 June 12, 2006, between Spansion LLC, Spansion Inc., Spansion Technology Inc. and Wells Fargo Bank, N.A., governing the 2.25% Exchangeable Senior Subordinated Debentures due 2016, and including the form 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 15, 2006, is hereby incorporated by reference.
- 4.4 Indenture, dated May 18, 2007, between Spansion LLC, Spansion Inc., Spansion Technology Inc. and Wells Fargo Bank, N.A., governing the Senior Secured Floating Rate Notes due 2013, and including the 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.
- 10.64(b) Amendment No. 3 to Credit Agreement and Amendment No. 2 to Security Agreement, dated as of May 9, 2007, by and among Spansion LLC, Spansion Inc., Spansion International, Inc., Bank of America, N.A., as administrative agent, and the other lenders party thereto.
- 10.65(b) Amendment to Facility Agreement, dated as of August 1, 2007, among Spansion Japan Limited, GE Capital Leasing Corporation, Sumisho Lease Co., Ltd., Mitsui Leasing & Development, Ltd., and certain lenders thereto.
- 10.67(b) Amendment to Security Agreement, dated as of April 26, 2007, among Spansion Japan Limited, GE Capital Leasing Corporation and the Finance Parties.
- 10.73 Spansion Inc. 2007 Equity Incentive Plan.
- 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: August 10, 2007

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